ANNALY CAPITAL MANAGEMENT INC
Form 10-K
February 16, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2017

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _______________ TO _________________

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)

MARYLAND (State or other jurisdiction of incorporation or organization)	22-3479661 (IRS Employer Identification No.)
1211 AVENUE OF THE AMERICAS NEW YORK, NEW YORK (Address of principal executive offices)	10036 (Zip Code)

(212) 696-0100
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	New York Stock Exchange
7.625% Series C Cumulative Redeemable Preferred Stock	New York Stock Exchange
7.50% Series D Cumulative Redeemable Preferred Stock	New York Stock Exchange
	New York Stock Exchange

6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	
6.50% Series G Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

At June 30, 2017, the aggregate market value of the voting common stock held by non-affiliates of the Registrant was approximately $12.2 billion, based on the closing sales price of the Registrant's common stock on such date as reported on the New York Stock Exchange.

The number of shares of the Registrant's Common Stock outstanding on January 31, 2018 was 1,159,623,410.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2017. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

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PART I
ITEM 1. BUSINESS

"Annaly," "we," "us," or "our" refers to Annaly Capital Management, Inc. and our wholly-owned subsidiaries, except where it is made clear that the term means only the parent company.

Refer to the section titled "Glossary of Terms" located at the end of Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." for definitions of certain of the commonly used terms in this annual report on Form 10-K.

The following description of our business should be read in conjunction with the Consolidated Financial Statements and the related Notes thereto, and the information set forth under the heading "Special Note Regarding Forward-Looking Statements" in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Business

Business Overview

We are a leading diversified capital manager that invests in and finances residential and commercial assets. Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments, and continuous management of our portfolio. We are a Maryland corporation that has elected to be taxed as a real estate investment trust ("REIT"). We are externally managed by Annaly Management Company LLC ("Manager"). We were founded in 1997 and our

common stock is listed on the New York Stock Exchange under the ticker symbol "NLY".

We use our capital coupled with borrowed funds to invest primarily in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings and hedging activities.

Investment Groups

Our investment groups are comprised of the following:

Investment Groups	Description
Annaly Agency Group	Invests in Agency mortgage-backed securities ("MBS") collateralized by residential mortgages which are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.
Annaly Residential Credit Group	Invests primarily in non-Agency residential mortgage assets within securitized products and residential mortgage loan markets.
Annaly Commercial Real Estate Group	Originates and invests in commercial mortgage loans, securities, and other commercial real estate debt and equity investments.
Annaly Middle Market Lending Group	Provides financing to private equity-backed middle market businesses across the capital structure.

We have made significant investments in our business as part of the diversification of our investment strategy. Our operating platform has expanded in support of our diversification strategy, and has included investments in systems, infrastructure and personnel. Our operating platform supports our investments in Agency assets as well as residential credit assets, commercial real estate, residential mortgage loans, mortgage servicing rights ("MSRs"), and corporate loans. The diversity of our investment alternatives provides us the flexibility to adapt to changes in market conditions and to take advantage of potential resulting opportunities.

We believe that our business objectives are supported by our size and conservative financial posture relative to the industry, the extensive experience of our Manager's

employees, the diversity of our investment strategy, a comprehensive risk management approach, the availability and diversification of financing sources, our corporate structure and our operational efficiencies.

Investment Strategy and Capital Allocation Policy

We seek to achieve attractive risk-adjusted returns and preservation of capital over the long term through investment in a diversified portfolio of target assets. Under our capital allocation policy, subject to oversight by our board of directors ("Board"), we may allocate our investments within our target asset classes as we determine to be appropriate from time to time. The following target assets have been approved for investment under our capital allocation policy.

Residential	Commercial
Ø Agency mortgage-backed securities	Ø Commercial real estate, including:

Ø To-be-announced forward contracts (“TBAs”)
Ø Agency debentures
Ø Residential credit investments, including:
Residential mortgage loans
Residential mortgage-backed securities
Agency or private label credit risk sharing transactions
Ø Mortgage servicing rights

Commercial mortgage loans
Commercial mortgage-backed securities
Preferred equity
Other real estate-related debt investments
Real property
Ø Corporate debt including loans and securities of middle market companies

Our Board may adopt changes to our capital allocation policy and targeted assets at its discretion.

The nature of our assets and our operations are intended to meet our REIT qualification requirements and our exemption

from registration as an investment company under the Investment Company Act of 1940, as amended (“Investment Company Act”).

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ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1. Business

Our Portfolio and Capital Allocation

Our portfolio composition and capital allocation at December 31, 2017 and 2016 were as follows:

Category	December 31, 2017 Percentage of Portfolio	December 31, 2017 Capital Allocation (1)	December 31, 2016 Percentage of Portfolio	December 31, 2016 Capital Allocation (1)
Residential				
Agency mortgage-backed securities and debentures (2)	91.2%	76%	89.3%	80%
Residential credit investments	3.2%	11%	2.9%	7%
Commercial				
Commercial real estate	4.6%	8%	6.9%	9%
Corporate debt	1.0%	5%	0.9%	4%

(1) Capital allocation represents the percentage of stockholders' equity invested in each category.
(2) Includes MSRs.

Risk Appetite Statement

We maintain a firm-wide risk appetite statement which defines the level and types of risk that we are willing to take in order to achieve our business objectives and reflects our risk management philosophy. We will only engage in risk activities that are expected to enhance value for our

stockholders based on our core expertise. Our activities focus on capital preservation and income generation through proactive portfolio management, supported by a conservative liquidity and leverage posture.

Our risk appetite statement asserts the following key risk parameters to guide our investment management activities:

Risk Parameter	Description
Portfolio composition	We will maintain a portfolio comprised of target assets approved by our Board and in accordance with our capital allocation policy.
Leverage	We will operate at an economic leverage ratio no greater than 10:1.
Liquidity risk	We will seek to maintain an unencumbered asset portfolio sufficient to meet our liquidity needs under adverse market conditions.
Interest rate risk	We will seek to manage interest rate risk to protect the portfolio from adverse rate movements utilizing derivative instruments targeting both income and capital preservation.
Credit risk	We will seek to manage credit risk by making investments which conform within our specific investment policy parameters and optimize risk-adjusted returns.
Capital preservation	We will seek to protect our capital base through disciplined risk management practices.
Compliance	We will comply with regulatory requirements needed to maintain our REIT status and our exemption from registration under the Investment Company Act.

Our Board has reviewed and approved the investment and operating policies and strategies that support our risk appetite statement established by our Manager and set forth in this Form 10-K. Our Board has the power to modify or waive these policies and strategies to the extent that our Board, in its discretion, determines that the modification or waiver is in the best interests of our stockholders. Among other factors, market developments which affect our policies and strategies or which change our assessment of the market may cause our Board to revise our policies and strategies.

We may seek to expand our capital base in order to further increase our ability to acquire new and different types of assets when the potential returns from new investments appear attractive relative to the targeted risk-adjusted returns. We may in the future acquire assets by offering our debt or equity securities in exchange for the assets.

Target Assets

Within the confines of the risk appetite statement, we seek to generate the highest risk-adjusted returns on capital invested, after consideration of the following:

- The amount, nature and variability of anticipated cash flows from the asset across a variety of interest rate, yield, spread, financing cost, credit loss and prepayment scenarios;
- The liquidity of the asset;
- The ability to pledge the asset to secure collateralized borrowings;
- When applicable, the credit of the underlying borrower;
- The costs of financing, hedging and managing the asset;
- The impact of the asset to our REIT compliance and our exemption from registration under the Investment Company Act; and
- The capital requirements associated with the purchase and financing of the asset.

We target the purchase and sale of the assets listed below as part of our investment strategy. Our targeted assets and asset

acquisition strategy may change over time as market conditions change and as our business evolves.

Targeted Asset Class	Description
Residential	
Agency mortgage-backed securities	Our primary investments consist of Agency pass-through certificates, collateralized mortgage obligations (“CMOs”) issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae and other securities such as interest-only securities and inverse floaters. These securities are backed by single-family or multi-family residences with loan maturities typically ranging from 15 to 40 years and may have fixed or floating coupons.
TBAs	We purchase and sell TBAs which are forward contracts for Agency mortgage-backed securities. TBA contracts specify a few basic characteristics of the Agency mortgage-backed securities, such as the coupon rate, the issuer, term, and the approximate face value of the bonds to be delivered, with the actual bonds to be delivered only identified shortly before the TBA settlement date.
Agency debentures	We invest in debt issued by Freddie Mac, Fannie Mae or the Federal Home Loan Banks. These debentures are not backed by collateral, but by the creditworthiness of the issuer.
Residential credit investments	We invest in residential credit investments including: investments in single-family and multi-family privately-issued certificates that are not issued by one of the Agencies, securities backed by a pool of non-performing or re-performing loans, Agency risk sharing transactions issued by Fannie Mae and Freddie Mac and similarly structured transactions arranged by third party market participants, individual residential mortgage loans and pools of residential mortgage loans.
Mortgage servicing rights	Through our subsidiary Hatteras Financial Corp., we invest in MSRs.
Commercial	
Commercial real estate	Through our subsidiary Annaly Commercial Real Estate Group, Inc., we originate and acquire commercial real estate debt including commercial mortgage loans, commercial mortgage-backed securities, B-notes, mezzanine loans, preferred equity and other commercial real estate-related debt investments. We also acquire real property for current cash flow, long-term appreciation and earnings growth. In implementing this strategy, we continually evaluate potential acquisition opportunities. These acquisitions may come through joint venture interests or from other equity investments. Although we continuously review our acquisition pipeline, there is not a specific metric that we apply to acquisitions that are under consideration, and our analysis may vary based on property type, transaction structure and other factors.
Corporate debt	Through our subsidiary Annaly Middle Market Lending LLC (“AMML”), we invest directly in the ownership of corporate loans and debt securities for middle market companies.

We believe that future interest rates and mortgage prepayment rates are very difficult to predict. Therefore, we seek to acquire assets which we believe will provide attractive returns over a broad range of interest rate and prepayment scenarios.

Capital Structure and Financing

Our capital structure is designed to offer an efficient complement of funding sources to generate positive risk-adjusted returns for our stockholders while maintaining appropriate liquidity to support our business and meet our financial obligations under periods of market stress. To maintain our desired capital profile, we utilize a mix of debt and equity funding. Debt funding may include the use of repurchase agreements, Federal Home Loan Bank (“FHLB”)

advances, loans, securitizations, participation sold, lines of credit, asset backed commercial paper conduits, corporate bond issuance, mortgages payable or other liabilities. Equity capital primarily consists of common and preferred stock.

We finance our Agency mortgage-backed securities and residential credit investments primarily with repurchase agreements. We also finance certain commercial real estate investments with repurchase agreements. We seek to diversify our exposure and limit concentrations by entering into repurchase agreements with multiple counterparties. We enter into repurchase agreements with national broker-dealers, commercial banks and other lenders that typically offer this type of financing. We enter into collateralized borrowings with financial institutions meeting internal credit standards and we monitor the financial condition of these institutions on a regular basis. At December 31, 2017, we had $77.7 billion of repurchase agreements outstanding.

Additionally, our wholly-owned subsidiary, RCap Securities, Inc. ("RCap"), provides direct access to bilateral and triparty funding as a FINRA member broker-dealer. As an eligible institution, RCap also raises funds through the General Collateral Finance Repo service offered by the Fixed Income Clearing Corporation ("FICC"), with FICC acting as the central counterparty. Since its inception in 2008, RCap has provided us greater depth and diversity of repurchase agreement funding while also limiting our counterparty exposure.

To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements. At December 31, 2017, the weighted average days to maturity was 58 days.

We maintain access to FHLB funding through our captive insurance subsidiary Truman Insurance Company LLC ("Truman"). We finance eligible Agency, residential and commercial investments through the FHLB. While a January 2016 Federal Housing Finance Agency ("FHFA") ruling requires captive insurance companies to terminate their FHLB membership, given the length of its membership Truman has been granted a five year sunset provision whereby its membership is scheduled to expire in February 2021. We believe our business objectives align well with the mission of the FHLB System. While there can be no assurances that such steps will be taken, we believe it would be appropriate for there to be legislative action to permit Truman and similar captive insurance subsidiaries to retain their membership status beyond the current sunset period.

We utilize diverse funding sources to finance our commercial investments. In addition to FHLB funding, we may utilize bilateral borrowing facilities, securitization funding and, in the case of equity investments in commercial real estate, mortgage financing.

We utilize leverage to enhance the risk-adjusted returns generated for our stockholders. We generally expect to maintain an economic leverage ratio of no greater than 10:1. This ratio varies from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our mix of assets, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and, lastly, our assessment of domestic and international market conditions. Since the financial crisis beginning in 2007, we have maintained an economic leverage ratio below 8:1, which is generally lower than our leverage ratio had been prior to 2007. For purposes of calculating this ratio, our economic debt is equal to the sum of Recourse Debt, TBA derivative notional outstanding and net forward purchases.

Our target economic leverage ratio is determined under our capital management policy. Should our actual economic

leverage ratio increase above the target level, we will consider appropriate actions which may include asset sales, changes in asset mix, reductions in asset purchases or originations, issuance of capital or other capital enhancing or risk reduction strategies.

The following table presents our leverage, economic leverage and capital ratios at December 31, 2017 and 2016.

	2017	2016
Leverage ratio	5.7:1	5.8:1
Economic leverage ratio	6.6:1	6.4:1
Capital ratio	12.9%	13.1%

Operating Platform

We maintain a flexible and scalable operating platform to support the management and maintenance of our diverse asset portfolio. We have invested in our infrastructure to enhance resiliency, efficiency and leveragability while also ensuring coverage of our target assets. Our information technology applications span the portfolio life-cycle including pre-trade analysis, trade execution and capture, trade settlement and financing, monitoring, and financial accounting and reporting.

Technology applications also support our control functions including risk, middle- and back-office functions. We have added breadth to our operating platform to accommodate diverse asset classes and drive automation-based efficiencies. Our business operations include a centralized collateral management function that permits in-house settlement and self-clearing, thereby creating greater control and management of our collateral. Through technology, we have also incorporated exception based processing, critical data assurance and paperless workflows. Our infrastructure investment has driven operating efficiencies while we have expanded the platform.

Risk Management

Risk is a natural element of our business. Effective risk management is of critical importance to the success of the firm. The objective of our risk management framework is to measure, monitor and manage the key risks to which we are subject. Our approach to risk management is comprehensive and has been designed to foster a holistic view of risk. For a full discussion of our risk management process and policies please refer to the section titled “Risk Management” of Part II, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Management Agreement

We have entered into a management agreement with the Manager pursuant to which our management is conducted by the Manager through the authority delegated to it in the

Management Agreement and pursuant to the policies established by our Board (the "Externalization"). The Management Agreement was effective as of July 1, 2013 and was amended on November 5, 2014 and amended and restated on April 12, 2016 (the management agreement, as amended and restated, is referred to as "Management Agreement").

The Management Agreement's current term ends on December 31, 2018 and will automatically renew for successive two-year terms unless at least two-thirds of our independent directors or the holders of a majority of our outstanding shares of common stock elect to terminate the agreement in their sole discretion and for any or no reason. At any time during the term or any renewal term we may deliver to the Manager written notice of our intention to terminate the Management Agreement. We must designate a date not less than one year from the date of the notice on which the Management Agreement will terminate. The Management Agreement also provides that the Manager may terminate the Management Agreement by providing to us prior written notice of its intention to terminate the Management Agreement no less than one year prior to the date designated by the Manager on which the Manager would cease to provide services or such earlier date as determined by us in our sole discretion.

Under the Management Agreement, the Manager, subject to the supervision and direction of our Board, is responsible for (i) the selection, purchase and sale of assets for our investment portfolio; (ii) recommending alternative forms of capital raising; (iii) supervising our financing and hedging activities; and (iv) day to day management functions. The Manager also performs such other supervisory and

management services and activities relating to our assets and operations as may be appropriate. In exchange for the management services, we pay the Manager a monthly management fee in an amount equal to 1/12th of 1.05% of our stockholders' equity (as defined in the Management Agreement), and the Manager is responsible for providing personnel to manage us and paying all compensation and benefit expenses associated with such personnel. All compensation and benefit expenses paid by us to individuals employed by certain of our subsidiaries reduces the amount we paid to the Manager. We do not pay the Manager any incentive fees.

The Management Agreement provides that during the term of the Management Agreement and, in the event of termination of this Agreement by the Manager without cause, for a period of one year following such termination, the Manager will not, without our prior written consent, manage any REIT which engages in the management of mortgage-backed securities in any geographical region in which we operate.

The Management Agreement may be amended or modified by agreement between us and the Manager. There is no termination fee for a termination of the Management Agreement by either us or the Manager.

Executive Officers

Our executive officers are provided and compensated by our Manager. We do not employ or compensate our executive officers. The following table sets forth certain information as of January 31, 2018 concerning our executive officers:

Name	Age	Title
Kevin G. Keyes	50	Chairman, Chief Executive Officer and President
Glenn A. Votek	59	Chief Financial Officer
David L. Finkelstein	45	Chief Investment Officer
Timothy P. Coffey	44	Chief Credit Officer
Anthony C. Green	43	Chief Legal Officer and Secretary

Kevin G. Keyes serves as Annaly's Chairman, Chief Executive Officer and President. Mr. Keyes has served as Chairman since January 2018, Chief Executive Officer since September 2015 and President since October 2012. Previously, Mr. Keyes served as Chief Strategy Officer and Head of Capital Markets of Annaly from September 2010 until October 2012. Prior to joining Annaly as a Managing Director in 2009, Mr. Keyes worked for 20 years in senior investment banking and capital markets roles. From 2005 to 2009, Mr. Keyes served in senior management and business origination roles in the Global Capital Markets and Banking Group at Bank of America Merrill Lynch. Prior to that, he worked at Credit Suisse First Boston from 1997 until 2005 in various capital markets origination roles and Morgan Stanley Dean Witter from 1990 until 1997 in the Mergers and Acquisitions Group and Real Estate Investment Banking

Group. Mr. Keyes holds a B.A. in Economics and a B.S. in Business Administration (ALPA Program) from the University of Notre Dame.

Glenn A. Votek has served as Chief Financial Officer of Annaly since August 2013. Mr. Votek also served as Chief Financial Officer of Fixed Income Discount Advisory Company ("FIDAC"), a former wholly-owned subsidiary of the Company, from August 2013 until October 2015. Mr. Votek joined Annaly in May 2013 from CIT Group where he had been an Executive Vice President and Treasurer since 1999 and President of Consumer Finance since 2012. Prior to that, Mr. Votek worked at AT&T and its finance subsidiary from 1986 until 1999 in various financial management roles. Mr. Votek has a B.S. in Finance and Economics from the

University of Arizona/Kean College and a M.B.A. in Finance from Rutgers University.

David L. Finkelstein has served as Chief Investment Officer of Annaly since November 2016. Mr. Finkelstein previously served as Annaly's Chief Investment Officer, Agency and RMBS beginning in February 2015 and as Annaly's Head of Agency Trading beginning in August 2013. Prior to joining Annaly in 2013, Mr. Finkelstein served for four years as an Officer in the Markets Group of the Federal Reserve Bank of New York where he was the primary strategist and policy advisor for the MBS purchase program. Mr. Finkelstein has over 20 years of experience in fixed income investment. Prior to the Federal Reserve Bank of New York, Mr. Finkelstein held Agency MBS trading positions at Salomon Smith Barney, Citigroup Inc. and Barclays PLC. Mr. Finkelstein received his B.A. in Business Administration from the University of Washington and his M.B.A. from the University of Chicago, Booth School of Business. Mr. Finkelstein also holds the Chartered Financial Analyst® designation.

Timothy P. Coffey has served as Chief Credit Officer of Annaly since January 2016. Mr. Coffey served as Annaly's Head of Middle Market Lending from 2010 until January 2016. Mr. Coffey has over 20 years of experience in leveraged finance and has held a variety of origination, execution, structuring and distribution positions. Prior to joining Annaly in 2010, Mr. Coffey served as Managing Director and Head of Debt Capital Markets in the Leverage Finance Group at Bank of Ireland. Prior to that, Mr. Coffey held positions at Scotia Capital, the holding company of Saul Steinberg's Reliance Group Holdings, and SC Johnson International. Mr. Coffey received his B.A. in Finance from Marquette University.

Anthony C. Green has served as Chief Legal Officer and Secretary of Annaly since March 2017. Mr. Green previously served as Annaly's Deputy General Counsel from 2009 until February 2017. Prior to joining Annaly, Mr. Green was a partner in the Corporate, Securities, Mergers & Acquisitions Group at the law firm K&L Gates LLP. Mr. Green has over 18 years of experience in corporate and securities law. Mr. Green holds a B.A. in Economics and Political Science from the University of Pennsylvania and a J.D. and LL.M. in International and Comparative Law from Cornell Law School.

Employees

Effective July 1, 2013, all of Annaly's employees were terminated by us and were hired by the Manager. However, a limited number of employees of our subsidiaries remain as employees of our subsidiaries for regulatory or corporate efficiency reasons. At December 31, 2017, our subsidiaries had 6 employees and the Manager had 146 employees. All compensation expenses we incur in connection with the employees of our subsidiaries reduce the amount we paid to

the manager. For information about the management fee, see the discussion in the "Management Agreement" section.

Regulatory Requirements

We have elected, organized and operated in a manner that qualifies us to be taxed as a REIT under the Internal Revenue Code of 1986, as amended and regulations promulgated thereunder (the "Code"). So long as we qualify for taxation as a REIT, we generally will not be subject to federal income tax on our taxable income that is distributed to our stockholders. Furthermore, substantially all of our assets, other than our taxable REIT subsidiaries ("TRSs"), consists of qualified REIT real estate assets (of the type described in Section 856(c)(5) of the Code).

We regularly monitor our investments and the income from these investments and, to the extent we enter into hedging transactions, we monitor income from our hedging transactions as well, so as to ensure at all times that we maintain our qualification as a REIT and our exemption from registration under the Investment Company Act.

RCap is a member of FINRA and is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping and conduct of directors, officers and employees. As a self-clearing, registered broker dealer, RCap is required to maintain minimum net capital by FINRA. RCap consistently operates with capital in excess of its regulatory capital requirements as defined by SEC Rule 15c3-1.

The financial services industry has been the subject of intense regulatory scrutiny in recent years. Financial institutions have been subject to increasing regulation and supervision in the U.S. In particular, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”), which was enacted in July 2010, significantly altered the financial regulatory regime within which financial institutions operate. The implications of the Dodd-Frank Act for our business depend to a large extent on the rules that have been or will be adopted by the Federal Reserve Board, the FDIC, the SEC, the Commodity and Futures Trading Commission (“CFTC”) and other agencies to implement the legislation, as well as the development of market practices and structures under the regime established by the legislation and the implementation of the rules. Other reforms have been adopted or are being considered by other regulators and policy makers worldwide. We will continue to assess our business, risk management, and compliance practices to conform to developments in the regulatory environment.

Competition

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities. In acquiring our target assets, we will compete with financial institutions, institutional investors, other lenders, government entities and certain other REITs. For a full discussion of the risks associated with competition see the “Risks Related to Our Investing, Portfolio Management and Financing Activities” section in Item 1A. “Risk Factors.”

Corporate Governance

We strive to conduct our business in accordance with the highest ethical standards and in compliance with applicable governmental laws, rules and regulations.

- Our Board is composed of a majority of independent directors, and our Audit, Compensation and Nominating/Corporate Governance Committees are composed exclusively of independent directors.
- Our independent directors annually select an independent director to serve as lead independent director.
- We have adopted a Code of Business Conduct and Ethics, which sets forth the basic principles and guidelines for resolving various legal and ethical questions that may arise in the workplace and in the conduct of our business. This code is applicable to our directors, officers and employees as well as those of our Manager and subsidiaries.
- We have adopted Corporate Governance Guidelines which, in conjunction with the charters of our Board committees, provide the framework for the governance of our company.
- We have procedures by which any employee, officer or director may raise concerns confidentially about our company’s conduct, accounting, internal controls or auditing matters with the lead independent director, the independent directors, or the chair of the Audit Committee or through our company’s whistleblower phone hotline or e-mail inbox.
- We have an Insider Trading Policy that prohibits our directors, officers and employees, including employees of our Manager, as well as those of our subsidiaries from buying or selling our securities on the basis of material nonpublic information and prohibits communicating material nonpublic information about our company to others. Our Insider Trading Policy prohibits our officers and employees, from (1) pledging our stock as collateral for a loan or (2) engaging in any hedging transactions with respect to our equity securities held by them.
- Our Board has instituted expansive employee stock ownership guidelines, pursuant to which more than 40% of our employees, including employees of our Manager, as well as those of our subsidiaries, are asked to purchase predetermined amounts of Company common stock in the open market.

Distributions

In accordance with the requirements for maintaining REIT status, we intend to distribute to stockholders aggregate

dividends equaling at least 90% of our REIT taxable income (determined without regard to the deduction of dividends paid and by excluding any net capital gain) for each taxable year and will endeavor to distribute at least 100% of our REIT taxable income so as not to be subject to tax. Distributions of economic profits from our enterprise could be classified as return of capital due to differences between book and tax accounting rules. We may make additional returns of capital when the potential risk-adjusted returns from new investments fail to exceed our cost of capital. Subject to the limitations of applicable securities and state corporation laws, we can return capital by making purchases of our own capital stock or through payment of dividends.

Available Information

Our website is www.annaly.com . We make available on this website under “Investors - SEC Filings,” free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the SEC.

Also posted on our website, and available in print upon request of any stockholder to our Investor Relations Department, are charters for our Audit Committee, Compensation Committee, Nominating/Corporate Governance Committee, Risk Committee and Public Responsibility Committee, our Corporate Governance Guidelines and our Code of Business Conduct and Ethics. Within the time period required by the SEC, we will post on our website any amendment to the Code of Business Conduct and Ethics and any waiver applicable to any executive officer, director or senior financial officer.

Our Investor Relations Department can be contacted at:

Annaly Capital Management, Inc.
1211 Avenue of the Americas
New York, New York 10036
Attn: Investor Relations
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The SEC also maintains a website that contains reports, proxy and information statements and other information we file with the SEC at www.sec.gov . Copies of these reports, proxy and information statements and other information may also be obtained, after paying a duplicating fee, by electronic request at publicinfo@sec.gov, or by writing the SEC's Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-0102. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1A. Risk Factors

ITEM 1A. RISK FACTORS

An investment in our stock involves a number of risks. Before making an investment decision, you should carefully consider all of the risks described in this Form 10-K. If any of the risks discussed in this Form 10-K actually occur, our business, financial condition and results of operations could

be materially adversely affected. If this were to occur, the trading price of our stock could decline significantly and you may lose all or part of your investment. Readers should not consider any descriptions of these factors to be a complete set of all potential risks that could affect us.

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Risks Related to Our Investing, Portfolio Management and Financing Activities

We may change our policies without stockholder approval.

Our Manager is authorized to follow very broad investment guidelines that may be amended from time to time. Our Board and management determine all of our significant policies, including our investment, financing, capital and asset allocation and distribution policies. They may amend or revise these policies at any time without a vote of our stockholders. Policy changes could adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or distributions.

Our investment in new business strategies and new assets is inherently risky, and could disrupt our ongoing businesses.
To date, a significant portion of our total assets have consisted of Agency mortgage-backed securities and Agency debentures which carry an implied or actual “AAA” rating. Nevertheless, pursuant to the ongoing diversification of our assets, we also acquire assets of lower credit quality.
While we remain committed to the Agency market and have grown our Agency assets, given the current environment, we believe it is prudent to diversify a portion of our investment portfolio. For example, during 2017 we also focused on growth in our middle market lending and residential credit businesses, and expect that trend to continue during 2018. We invest in a range of targeted asset classes and continue to explore new business strategies and assets and expect to continue to do so in the future.

Additionally, we may enter into or engage in various types of securitizations, transactions, services and other operating businesses that are different than the types we have traditionally entered into or engaged in.

Such endeavors may involve significant risks and uncertainties, including credit risk, diversion of management from current operations, expenses associated with these new investments, inadequate return of capital on our investments, and unanticipated issues not discovered in our due diligence of such strategies and assets. Because these new ventures are inherently risky, no assurance can be given that such strategies will be successful and will not materially adversely affect our reputation, financial condition, and operating results.

Our strategy involves the use of leverage, which increases the risk that we may incur substantial losses.

We expect our leverage to vary with market conditions and our assessment of risk/return on investments. We incur this leverage by borrowing against a substantial portion of the market value of our assets. Leverage, which is fundamental to our investment strategy, creates significant risks.

Because of our leverage, we may incur substantial losses if our borrowing costs increase. The reasons our borrowing costs may increase include, but are not limited to, the following:

- short-term interest rates increase (such as was experienced during 2017);
- the market value of our investments decreases;

- the "haircut" applied to our assets under the repurchase agreements or other secured financing arrangements we are party to increases;
- interest rate volatility increases; or
- the availability of financing in the market decreases.

Our leverage may cause margin calls and defaults and force us to sell assets under adverse market conditions.

Because of our leverage, a decline in the value of our interest earning assets may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. Our fixed-rate mortgage-backed securities generally are more susceptible to margin calls as increases in interest rates tend to more negatively affect the market value of fixed-rate securities.

If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. This could force us to sell our interest earning assets under adverse market conditions. Additionally, in the event of our bankruptcy, our borrowings, which are generally made under repurchase agreements, may qualify for special treatment under the Bankruptcy Code. This special treatment would allow the lenders under these agreements to avoid the automatic stay provisions of the Bankruptcy Code and to liquidate the collateral under these agreements without delay.

We may exceed our target leverage ratios.

We generally expect to maintain an economic leverage ratio of less than 10:1. However, we are not required to stay below this economic leverage ratio. We may exceed this ratio by incurring additional debt without increasing the amount of equity we have. For example, if we increase the amount of borrowings under our master repurchase agreements with our existing or new counterparties or the market value of our portfolio holdings declines, our economic leverage ratio would increase. If we increase our economic leverage ratio, the adverse impact on our financial condition and results of operations from the types of risks associated with the use of leverage would likely be more severe.

We may not be able to achieve our optimal leverage.

We use leverage as a strategy to increase the return to our investors. However, we may not be able to achieve our desired leverage for any of the following reasons:

- we determine that the leverage would expose us to excessive risk;
- our lenders do not make funding available to us at acceptable rates; or
- our lenders require that we provide additional collateral to cover our borrowings.

Failure to procure or renew funding on favorable terms, or at all, would adversely affect our results and financial condition.

One or more of our lenders could be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce our liquidity. Furthermore, if any of our potential lenders or existing lenders is unwilling or unable to provide us with financing or if we are not able to renew or replace maturing borrowings, we could be forced to sell our assets at an inopportune time when prices are depressed. Our business, results of operations and financial condition may be materially adversely affected by disruptions in the financial markets. We cannot assure you, under such extreme conditions, that these markets will remain an efficient source of long-term financing for our assets. If our strategy is not viable, we will have to find alternative forms of financing for our assets, which may not be available. Further, as a REIT, we are required to distribute annually at least 90% of our REIT taxable income (subject to certain adjustments) to our stockholders and are, therefore, not able to retain significant amounts of our earnings for new investments. We cannot assure you that any, or sufficient, funding or capital will be available to us in the future on terms that are acceptable to us. If we cannot obtain sufficient funding on acceptable terms, there may be a negative impact on the market price of our common stock and our ability to make distributions to our stockholders. Moreover, our ability to grow will be dependent on our ability to procure additional funding. To the extent we are not able to raise additional funds through the issuance of additional equity or borrowings, our growth will be constrained.

Failure to effectively manage our liquidity would adversely affect our results and financial condition.

Our ability to meet cash needs depends on many factors, several of which are beyond our control. Ineffective management of liquidity levels could cause us to be unable to meet certain financial obligations. Potential conditions that could impair our liquidity include: unwillingness or inability of any of our potential lenders to provide us with or renew financing, calls on margin, additional capital requirements, a disruption in the financial markets or declining confidence in our reputation or in financial markets in general. These conditions could force us to sell our assets at inopportune times or otherwise cause us to potentially revise our strategic business initiatives.

Risk management policies and procedures may not adequately identify all risks to our businesses.

We have established and maintain risk management policies and procedures designed to support our risk framework, established to: identify, measure, monitor and control financial risks. Risks include: market risk (interest rate, spread and prepayment), liquidity risk, credit risk and operational risk. These policies and procedures may not sufficiently identify the full range of risks that we are or may become exposed to. Any changes to business activities, including expansion of traded products, may result in our being exposed to different risks or an increase in certain risks. Any failure to identify and mitigate financial risks could result in an adverse impact in our financial condition, business or results of operation. Additionally, as regulations and markets in which we operate continue to evolve, our risk management policies and procedures may not always keep sufficient pace with those changes.

An increase or decrease in prepayment rates may adversely affect our profitability.

The mortgage-backed securities we acquire are backed by pools of mortgage loans. We receive payments, generally, from the payments that are made on these underlying mortgage loans. We often purchase mortgage-backed securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire these mortgage-backed securities. In accordance with GAAP, we amortize the premiums on our mortgage-backed securities over the life of the related mortgage-backed securities. If the mortgage loans securing these mortgage-backed securities prepay at a more rapid rate than anticipated, we will have to amortize our premiums on an accelerated basis that may adversely affect our profitability.

Defaults on mortgage loans underlying Agency mortgage-backed securities typically have the same effect as prepayments because of the underlying Agency guarantee.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans. While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

Conversely, a decline in prepayment rates on our investments will reduce the amount of principal we receive and therefore reduce the amount of cash we otherwise could have reinvested in higher yielding assets at that time, which could negatively impact our future operating results.

We are subject to reinvestment risk.

We also are subject to reinvestment risk as a result of changes in interest rates. Declines in interest rates are generally accompanied by increased prepayments of mortgage loans, which in turn results in a prepayment of the related mortgage-backed securities. An increase in prepayments could result in the reinvestment of the proceeds we receive from such prepayments into lower yielding assets.

Volatile market conditions for mortgages and mortgage-related assets as well as the broader financial markets can result in a significant contraction in liquidity for mortgages and mortgage-related assets, which may adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage-related assets, including Agency mortgage-backed securities, as well as the broader financial markets and the economy generally.

Significant adverse changes in financial market conditions can result in a deleveraging of the global financial system and the forced sale of large quantities of mortgage-related and other financial assets. Concerns over economic recession, geopolitical issues, unemployment, the availability and cost of financing, the mortgage market and a declining real estate market may contribute to increased volatility and diminished expectations for the economy and markets.

For example, as a result of the financial market conditions beginning in the summer of 2007 and through the subsequent credit and housing crisis, many traditional mortgage investors suffered severe losses in their residential mortgage portfolios and several major market participants failed or were impaired, resulting in a significant contraction in market liquidity for mortgage-related assets. This illiquidity negatively affected both the terms and availability of financing for all mortgage-related assets.

Further increased volatility and deterioration in the markets for mortgages and mortgage-related assets as well as the broader financial markets may adversely affect the performance and market value of our Agency mortgage-backed securities. If these conditions exist, institutions from which we seek financing for our investments may tighten their lending standards or become insolvent, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability and financial condition may be adversely affected if we are unable to obtain cost-effective financing for our investments.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these assets.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. In acquiring our target assets, we will compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds, government entities, commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Other REITs with investment objectives that overlap with ours may elect to raise significant amounts of capital, which may create additional competition for investment opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the Investment Company Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot provide assurance that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our target assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

An increase in the interest payments on our borrowings relative to the interest we earn on our interest earning assets may adversely affect our profitability.

We earn money based upon the spread between the interest payments we earn on our interest earning assets and the interest payments we must make on our borrowings. If the interest payments on our borrowings increase relative to the interest we earn on our interest earning assets, our profitability may be adversely affected.
Differences in timing of interest rate adjustments on our interest earning assets and our borrowings may adversely affect our profitability.
We rely primarily on short-term borrowings to acquire interest earning assets with long-term maturities. Some of the interest earning assets we acquire are adjustable-rate interest earning assets. This means that their interest rates may vary over time based upon changes in an objective index, such as:

- LIBOR. The rate banks charge each other for short-term Eurodollar loans.
- Treasury Rate. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. The interest rates on our borrowings similarly vary with changes in an objective index. Nevertheless, the interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate interest earning assets, which are also typically subject to periodic and lifetime interest rate caps. Accordingly, in a period of rising interest rates, we

could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate interest earning assets.

Changes in banks’ inter-bank lending rate reporting practices or the method pursuant to which LIBOR is determined may adversely affect the value of the financial obligations to be held or issued by us that are linked to LIBOR.

LIBOR and other indices which are deemed “benchmarks” are the subject of recent national, international, and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause such benchmarks to perform differently than in the past, or have other consequences which cannot be predicted. In particular, regulators and law enforcement agencies in the U.K. and elsewhere are conducting criminal and civil investigations into whether the banks that contributed information to the British Bankers’ Association (“BBA”) in connection with the daily calculation of LIBOR may have been under-reporting or otherwise manipulating or attempting to manipulate LIBOR. A number of BBA member banks have entered into settlements with their regulators and law enforcement agencies with respect to this alleged manipulation of LIBOR. Actions by the regulators or law enforcement agencies, as well as ICE Benchmark Administration (the current administrator of LIBOR), may result in changes to the manner in which LIBOR is determined or the establishment of alternative reference rates. For example, on July 27, 2017, the U.K. Financial Conduct Authority announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021.

At this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be implemented in the U.K. or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the market for or value of any securities on which the interest or dividend is determined by reference to LIBOR, loans, derivatives and other financial obligations or on our overall financial condition or results of operations. More generally, any of the above changes or any other consequential changes to LIBOR or any other “benchmark” as a result of international, national or other proposals for reform or other initiatives or investigations, or any further uncertainty in relation to the timing and manner of implementation of such changes, could have a material adverse effect on the value of and return on any securities based on or linked to a “benchmark.”

An increase in interest rates may adversely affect the market value of our interest earning assets and, therefore, also our book value.

Increases in interest rates may negatively affect the market value of our interest earning assets because in a period of rising interest rates, the value of certain interest earning assets may fall and reduce our book value. In addition, our fixed-rate interest earning assets are generally more negatively affected by increases in interest rates because in a period of rising rates, the coupon we earn on our fixed-rate interest earning assets would not change. Our book value would be reduced by the amount of a decline in the market value of our interest earning assets.

We may experience declines in the market value of our assets resulting in us recording impairments, which may have an adverse effect on our results of operations and financial condition.

A decline in the market value of our mortgage-backed securities or other assets may require us to recognize an "other-than-temporary" impairment ("OTTI") against such assets under U.S. generally accepted accounting principles ("GAAP"). For a discussion of the assessment of OTTI, see the section titled "Significant Accounting Policies" in the Notes to the Consolidated Financial Statements included in Item 15. "Exhibits, Financial Statement Schedules." The determination as to whether an OTTI exists and, if so, the amount we consider other-than-temporarily impaired is subjective, as such determinations are based on both factual and subjective information available at the time of assessment. As a result, the timing and amount of OTTI constitute material estimates that are susceptible to significant change.

The viability of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, borrower, or other relationships. We have exposure to many different counterparties, and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of our counterparty or, in certain instances, our counterparty's customers. There is no assurance that any such losses would not materially and adversely impact our revenues, financial condition and earnings.

Our hedging strategies may be costly, and may not hedge our risks as intended.

Our policies permit us to enter into interest rate swaps, caps and floors, interest rate swaptions, U.S. Treasury futures and other derivative transactions to help us mitigate our interest rate and prepayment risks described above subject to maintaining our qualification as a REIT. We have used interest rate swaps and options to enter into interest rate swaps (commonly referred to as interest rate swaptions) to provide a level of protection against interest rate risks. We may also purchase or sell TBAs on Agency mortgage-backed securities, purchase or write put or call options on TBAs and invest in other types of mortgage derivatives, such as interest-only securities. No hedging strategy can protect us completely. Entering into interest rate hedging may fail to protect or could adversely affect us because, among other things: interest rate hedging can be expensive, particularly during periods of volatile interest rates; available hedges may not correspond directly with the risk for which protection is sought; and the duration of the hedge may not match the duration of the related asset or liability.

Our use of derivatives may expose us to counterparty and liquidity risks.

The CFTC has issued and continues to issue new rules regarding swaps and swaptions, under the authority granted to it pursuant to the Dodd-Frank Act. These new rules change, but do not eliminate, the risks we face in our hedging activities.

Most swaps that we enter into must be cleared by a Derivatives Clearing Organization (“DCO”). DCOs are subject to regulatory oversight, use extensive risk management processes, and might receive “too big to fail” support from the government in the case of insolvency. We access the DCO through several Futures Commission Merchants (“FCMs”). For any cleared swap, we bear the credit risk of both the DCO and the relevant FCM, in the form of potential late or unrecoverable payments, potential difficulty or delay in accessing collateral that we have posted, and potential loss of any positive market value of the swap position. In the event of a default by the DCO or FCM, we also bear market risk, because the asset being hedged is no longer effectively hedged.

Most swaps must be cleared through a DCO. Most swaps must be or are traded on a Swap Execution Facility. We bear additional fees for use of the DCO. We also bear fees for use of the Swap Execution Facility, and bear increased risk of trade errors. Because the standardized swaps available on Swap Execution Facilities and cleared through DCOs are not as customizable as the swaps available before the implementation of Dodd-Frank Act, we may bear additional basis risk from hedge positions that do not exactly reflect the interest rate risk on the asset being hedged.

Futures transactions are subject to risks analogous to those of cleared swaps, except that for futures transactions we bear a higher risk that collateral we have posted is unavailable to us if the FCM defaults.

Some derivatives transactions, such as swaptions, are not currently required to be cleared through a DCO. Therefore, we bear the credit risk of the dealer with which we executed the swaption. TBA contracts are also not cleared, and we bear the credit risk of the dealer.

Derivative transactions are subject to margin requirements. The relevant contract or clearinghouse rules dictate the method of determining the required amount of margin, the types of collateral accepted, and the timing required to meet margin calls. Additionally, for cleared swaps and futures, FCMs may have the right to require more margin than the clearinghouse requires. The requirement to meet margin calls can create liquidity risks, and we bear the cost of funding the margin that we post. Also, as discussed above, we bear credit risk if a dealer, FCM, or clearinghouse is holding collateral we have posted.

Generally, we attempt to retain the ability to close out of a hedging position or create an offsetting position. However, in some cases we may not be able to do so at economically viable prices, or we may be unable to do so without consent of the counterparty. Therefore, in some situations a derivative position can be illiquid, forcing us to hold it to its maturity or scheduled termination date.

Regulations relating to derivatives continue to be issued and come into effect. Ongoing regulatory change in this area could increase costs, increase risks, and adversely affect our business and results of operations.

It may be uneconomical to "roll" our TBA dollar roll transactions or we may be unable to meet margin calls on our TBA contracts, which could negatively affect our financial condition and results of operations.

From time to time, we enter into TBAs as an alternate means of investing in and financing Agency mortgage-backed securities. A TBA contract is an agreement to purchase or sell, for future delivery, an Agency mortgage-backed security with a specified issuer, term and coupon. A TBA dollar roll represents a transaction where TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the “drop”. The drop is a reflection of the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, that would be foregone as a result of settling the contract in the later month rather than in the earlier month. The drop between the current settlement month price and the forward settlement month price occurs because in the TBA dollar roll market, the party providing the implied financing is the party that would retain all principal and interest payments accrued during the financing period. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income earned on the underlying Agency mortgage-backed security less an implied financing cost. Consequently, dollar roll transactions and such forward purchases of Agency securities represent a form of off-balance sheet financing and increase our "at risk" leverage.

The economic return of a TBA dollar roll generally equates to interest income on a generic TBA-eligible security less an implied financing cost, and there may be situations in which the implied financing cost exceeds the interest income, resulting in a negative carry on the position. If we roll our TBA dollar roll positions when they have a negative carry, the positions would decrease net income and amounts available for distributions to shareholders.

There may be situations in which we are unable or unwilling to roll our TBA dollar roll positions. The TBA transaction could have a negative carry or otherwise be uneconomical, we may be unable to find counterparties with whom to trade in sufficient volume, or we may be required to collateralize the TBA positions in a way that is uneconomical. Because TBA dollar rolls represent implied financing, an inability or unwillingness to roll has effects similar to any other loss of financing. If we do not roll our TBA positions prior to the settlement date, we would have to take physical delivery of the underlying securities and settle our obligations for cash. We may not have sufficient funds or alternative financing sources available to settle such obligations. Counterparties may also make margin calls as the value of a generic TBA-eligible security (and therefore the value of the TBA contract) declines. Margin calls on TBA positions or failure to roll TBA positions could have the effects described in the liquidity risks described above.

We use analytical models and data in connection with the valuation of our assets, and any incorrect, misleading or incomplete information used in connection therewith would subject us to potential risks.

Given our strategies and the complexity of the valuation of our assets, we must rely heavily on analytical models (both proprietary models developed by us and those supplied by third parties) and information and data supplied by our third party vendors and servicers. Models and data are used to value assets or potential asset purchases and also in connection with hedging our assets. When models and data prove to be incorrect, misleading or incomplete, any decisions made in reliance thereon expose us to potential risks. For example, by relying on models and data, especially valuation models, we may be induced to buy certain assets at prices that are too high, to sell certain other assets at prices that are too low or to miss favorable opportunities altogether. Similarly, any hedging based on faulty models and data may prove to be unsuccessful. Furthermore, despite our valuation validation processes our models may nevertheless prove to be incorrect.

Some of the risks of relying on analytical models and third-party data are particular to analyzing tranches from securitizations, such as commercial or residential mortgage-backed securities. These risks include, but are not limited to, the following: (i) collateral cash flows and/or liability structures may be incorrectly modeled in all or only certain scenarios, or may be modeled based on simplifying assumptions that lead to errors; (ii) information about collateral may be incorrect, incomplete, or misleading; (iii) collateral or bond historical performance (such as historical prepayments, defaults, cash flows, etc.) may be incorrectly reported, or subject to interpretation (e.g., different issuers may report delinquency statistics based on different definitions of what constitutes a delinquent loan); or (iv)

collateral or bond information may be outdated, in which case the models may contain incorrect assumptions as to what has occurred since the date information was last updated.
Some of the analytical models used by us, such as mortgage prepayment models or mortgage default models, are predictive in nature. The use of predictive models has inherent risks. For example, such models may incorrectly forecast future behavior, leading to potential losses on a cash flow and/or a mark-to-market basis. In addition, the predictive models used by us may differ substantially from those models used by other market participants, with the result that valuations based on these predictive models may be substantially higher or lower for certain assets than actual market prices. Furthermore, since predictive models are usually constructed based on historical data supplied by third parties, the success of relying on such models may depend heavily on the accuracy and reliability of the supplied historical data and the ability of these historical models to accurately reflect future periods.

All valuation models rely on correct market data inputs. If incorrect market data is entered into even a well-founded valuation model, the resulting valuations will be incorrect. However, even if market data is inputted correctly, "model prices" will often differ substantially from market prices, especially for securities with complex characteristics, such as derivative instruments or structured notes.

Accounting rules related to certain of our transactions are highly complex and involve significant judgment and assumptions, and changes in accounting treatment may adversely affect our profitability and impact our financial results. Additionally, our application of GAAP may produce financial results that fluctuate from one period to another.

Accounting rules for valuations of investments, mortgage loan sales and securitizations, investment consolidations, acquisitions of real estate and other aspects of our operations are highly complex and involve significant judgment and assumptions. These complexities could lead to a delay in preparation of financial information and the delivery of this information to our stockholders. Changes in accounting interpretations or assumptions could impact our financial statements and our ability to prepare our financial statements in a timely fashion. Our inability to prepare our financial statements in a timely fashion in the future would likely adversely affect our share price significantly. The fair value at which our assets may be recorded may not be an indication of their realizable value. Ultimate realization of the value of an asset depends to a great extent on economic and other conditions. Further, fair value is only an estimate based on good faith judgment of the price at which an investment can be sold since market prices of investments can only be determined by negotiation between a willing buyer and seller. If we were to liquidate a particular asset, the realized value may be more than or less than the amount at which such asset was recorded. Accordingly, the value of our common shares could be adversely affected by our determinations regarding

the fair value of our investments, whether in the applicable period or in the future. Additionally, such valuations may fluctuate over short periods of time.

We have made certain accounting elections which may result in volatility in our periodic net income, as computed in accordance with GAAP. For example, changes in fair value of certain instruments are reflected in GAAP net income (loss) while others are reflected in Other comprehensive income (loss).

We are highly dependent on information systems and third parties, and systems failures or cybersecurity incidents could significantly disrupt our business, which may, in turn, negatively affect the market price of our common stock and our ability to operate our business.
Our business is highly dependent on communications and information systems. Any failure or interruption of our systems or cyber-attacks or security breaches of our networks or systems could cause delays or other problems in our securities trading activities, including mortgage-backed securities trading activities. A disruption or breach could also lead to unauthorized access to and release, misuse, loss or destruction of our confidential information or personal or

confidential information of our employees or third parties, which could lead to regulatory fines, costs of remediating the breach, reputational harm, and increased difficulty doing business with third parties that rely on us to meet their own data protection requirements. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the third parties with which we do business or that facilitate our business activities, including clearing agents or other financial intermediaries we use to facilitate our securities transactions, if their respective systems experience failure, interruption, cyber-attacks, or security breaches. We may face increased costs as we continue to evolve our cyber defenses in order to contend with changing risks. These costs and losses associated with these risks are difficult to predict and quantify, but could have a significant adverse effect on our operating results. Computer malware, viruses, computer hacking and phishing attacks have become more prevalent in our industry and may occur on our systems. We rely heavily on our financial, accounting and other data processing systems. Although we have not detected a material cybersecurity breach to date, other financial services institutions have reported material breaches of their systems, some of which have been significant. Even with all reasonable security efforts, not every breach can be prevented or even detected. It is possible that we have experienced an undetected breach. There is no assurance that we, or the third parties that facilitate our business activities, have not or will not experience a breach. It is difficult to determine what, if any, negative impact may directly result from any specific interruption or cyber-attacks or security breaches of our networks or systems (or the networks or systems of third parties that facilitate our business activities) or any failure to maintain performance, reliability and security of our technical infrastructure, but such computer malware, viruses, and computer hacking and phishing attacks may negatively affect our operations.

Our use of non-recourse securitizations may expose us to risks which could result in losses to us.

We may utilize non-recourse securitizations of our assets in mortgage loans, especially loans that we originate, when they are available. Prior to any such financing, we may seek to finance assets with relatively short-term facilities until a sufficient portfolio is accumulated. As a result, we would be subject to the risk that we would not be able to acquire, during the period that any short-term facilities are available, sufficient eligible assets to maximize the efficiency of a securitization. We also would bear the risk that we would not be able to obtain a new short-term facility or would not be able to renew any short-term facilities after they expire should we need more time to seek and acquire sufficient eligible assets for a securitization. In addition, conditions in the capital markets, including potential volatility and disruption in the capital and credit markets, may not permit a non-recourse securitization at any particular time or may make the issuance of any such securitization less attractive to us even when we do have sufficient eligible assets. While we would intend to retain the non-investment grade tranches of securitizations and, therefore, still have exposure to any assets included in such securitizations, our inability to enter into such securitizations would increase our overall exposure to risks associated with direct ownership of such assets, including the risk of default. Our inability to refinance any short-term facilities would also increase our risk because borrowings thereunder would likely be recourse to us as an entity. If we are unable to obtain and renew short-term facilities or to consummate securitizations to finance our assets on a long-term basis, we may be required to seek other forms of potentially less attractive financing or to liquidate assets at an inopportune time or price. To the extent that we are unable to obtain financing for our assets, to the extent that we retain such assets in our portfolio, our returns on investment and earnings will be negatively impacted.

Securitizations expose us to additional risks.

In a securitization structure, we convey a pool of assets to a special purpose vehicle, the issuing entity, and the issuing entity would issue one or more classes of non-recourse notes pursuant to the terms of an indenture. The notes are secured by the pool of assets. In exchange for the transfer of assets to the issuing entity, we receive the cash proceeds of the sale of non-recourse notes and a 100% interest in the subordinate interests of the issuing entity. The securitization of all or a portion of our commercial or residential mortgage loan portfolio might magnify our exposure to losses because any subordinate interest we retain in the issuing entity would be subordinate to the notes issued to investors and we would, therefore, absorb all of the losses sustained with respect to a securitized pool of assets before the owners of the notes experience any losses. Moreover, we cannot be assured that

we will be able to access the securitization market or be able to do so at favorable rates. The inability to securitize our portfolio could adversely affect our performance and our ability to grow our business.

Counterparties may require us to enter into restrictive covenants relating to our operations that may inhibit our ability to grow our business and increase revenues.

If or when we obtain debt financing, lenders (especially in the case of credit facilities) may impose restrictions on us that would affect our ability to incur additional debt, make certain allocations or acquisitions, reduce liquidity below certain levels, make distributions to our stockholders, or redeem debt or equity securities, and may impact our flexibility to determine our operating policies and strategies. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements, and our lenders could elect to declare outstanding amounts due and payable, terminate their commitments, require the posting of additional collateral and enforce their interests against existing collateral. We may also be subject to cross-default and acceleration rights and, with respect to collateralized debt, the posting of additional collateral and foreclosure rights upon default. A default and resulting repayment acceleration could significantly reduce our liquidity, which could require us to sell our assets to repay amounts due and outstanding. This could also significantly harm our business, financial condition, results of operations and ability to make distributions, which could cause our share price to decline. A default could also significantly limit our financing alternatives such that we would be unable to pursue our leverage strategy, which could adversely affect our returns.

Final rules issued by the FHFA relating to captive insurance company membership in the FHLB System prohibit us from taking new advances or renewing existing advances that mature beyond February 19, 2021.

On January 12, 2016, the FHFA issued final rules ("FHFA Final Rules") providing that captive insurance companies will no longer be eligible for membership in the FHLB System. Because our wholly-owned subsidiary Truman was admitted as a member of the FHLB of Des Moines ("FHLB Des Moines") prior to September 2014, it is eligible under the FHFA Final Rules to remain as a member of the FHLB Des Moines through February 19, 2021. In addition, under the FHFA Final Rules, the FHLB Des Moines is permitted to allow advances that were outstanding prior to February 19, 2016 to remain outstanding until scheduled maturity, however we are not permitted to increase our existing FHLB advances.

We may enter into new lines of business, acquire other companies or engage in other strategic initiatives, each of which may result in additional risks and uncertainties in our businesses.

We may pursue growth through acquisitions of other companies or other strategic initiatives. To the extent we pursue strategic investments or acquisitions, undertake other strategic initiatives or consider new lines of business, we will face numerous risks and uncertainties, including risks associated with:

- the availability of suitable opportunities;
- the level of competition from other companies that may have greater financial resources;
- our ability to assess the value, strengths, weaknesses, liabilities and potential profitability of potential acquisition opportunities accurately and negotiate acceptable terms for those opportunities;
- the required investment of capital and other resources;
- the lack of availability of financing and, if available, the terms of any financings;
- the possibility that we have insufficient expertise to engage in such activities profitably or without incurring inappropriate amounts of risk;
- the diversion of management’s attention from our core businesses;
- the potential loss of key personnel of an acquired business;
- assumption of liabilities in any acquired business;
- the disruption of our ongoing businesses;
- the increasing demands on or issues related to the combining or integrating operational and management systems and controls;
- compliance with additional regulatory requirements;
- costs associated with integrating and overseeing the operations of the new businesses;
- failure to realize the full benefits of an acquisition, including expected synergies, cost savings, or sales or growth opportunities, within the anticipated timeframe or at all; and
- post-acquisition deterioration in an acquired business that could result in lower or negative earnings contribution and/or goodwill impairment charges.

Entry into certain lines of business may subject us to new laws and regulations with which we are not familiar, or from which we are currently exempt, and may lead to increased litigation and regulatory risk. Our strategy to increase investments in a line of business, such as our middle market lending and residential credit businesses, may lead to additional risk uncertainties. In addition, if a new or acquired business generates insufficient revenues or if we are unable to efficiently manage our expanded operations, our results of operations will be adversely affected. Our strategic initiatives may include joint ventures, in which case we will be subject to additional risks and uncertainties in that we may be dependent upon, and subject to liability, losses or reputational damage relating to systems, controls and personnel that are not under our control.

Investments in MSRs may expose us to additional risks.

Our investments in MSRs may subject us to certain additional risks, including the following:

- Investments in MSRs are highly illiquid and subject to numerous restrictions on transfer and, as a result, there is risk that we would be unable to locate a willing buyer or get required approval to sell MSRs in the future should we desire to do so.
- Our rights to the excess servicing spread are subordinate to the interests of Fannie Mae, Freddie Mac and Ginnie Mae, and are subject to extinguishment. Fannie Mae and Freddie Mac each require approval of the sale of excess servicing spreads pertaining to their respective MSRs. We have entered into acknowledgment agreements or subordination of interest agreements with them, which acknowledge our subordinated rights.
- Changes in minimum servicing compensation for agency loans could occur at any time and could negatively impact the value of the income derived from MSRs.

If we are not able to successfully manage these and other risks related to investing in MSRs, it may adversely affect our business, results of operations and financial condition.

Purchases and sales of Agency mortgage-backed securities by the Federal Reserve may adversely affect the price and return associated with Agency mortgage-backed securities.

The Federal Reserve owns approximately $1.8 trillion of Agency mortgage-backed securities as of December 31, 2017. Starting in October 2017, the Federal Reserve has begun to phase out its policy of reinvesting principal payments from its holdings of Agency mortgage-backed securities into new Agency mortgage-backed securities purchases, therefore causing a decline in Federal Reserve security holdings over time. While it is very difficult to predict the impact of the Federal Reserve portfolio runoff on the prices and liquidity of Agency mortgage-backed securities, returns on Agency mortgage-backed securities may be adversely affected as private investors seek higher yields to purchase larger amounts of Agency mortgage-backed securities.

New laws may be passed affecting the relationship between Fannie Mae and Freddie Mac, on the one hand, and the federal government, on the other, which could adversely affect the price of Agency mortgage-backed securities.

The interest and principal payments we expect to receive on the Agency mortgage-backed securities in which we invest are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Principal and interest payments on Ginnie Mae certificates are directly guaranteed by the U.S. government. Principal and interest payments relating to the securities issued by

Fannie Mae and Freddie Mac are only guaranteed by each respective Agency.

In September 2008, Fannie Mae and Freddie Mac were placed into the conservatorship of the FHFA, their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the U.S. Department of the Treasury has taken various actions intended to provide Fannie Mae and Freddie Mac with additional liquidity in an effort to ensure their financial stability. In December 2017, FHFA and the U.S. Treasury Department announced that Fannie Mae and Freddie Mac will each be allowed to retain $3.0 billion in capital reserve in order to cover ordinary income fluctuations.

Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the Secretary of the U.S. Treasury suggested that the guarantee payment structure of Fannie Mae and Freddie Mac in the U.S. housing finance market should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. The U.S. Treasury could also stop providing credit support to Fannie Mae and Freddie Mac in the future. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency mortgage-backed security and could have broad adverse market implications. If Fannie Mae or Freddie Mac was eliminated, or their structures were to change in a material manner that is not compatible with our business model, we would not be able to acquire Agency mortgage-backed securities from these entities, which could adversely affect our business operations.

The U.S. Government’s efforts to encourage refinancing of certain loans may affect prepayment rates for mortgage loans in mortgage-backed securities.

In addition to the increased pressure upon residential mortgage loan investors and servicers to engage in loss mitigation activities, the U.S. Government has encouraged the refinancing of certain loans, and this action may affect prepayment rates for mortgage loans. To the extent these and other economic stabilization or stimulus efforts are successful in increasing prepayment speeds for residential mortgage loans, such efforts could potentially have a negative impact on our income and operating results, particularly in connection with loans or Agency mortgage-backed securities purchased at a premium, interest-only securities or MSRs.

Actions of the U.S. Government, including the U.S. Congress, U.S. Federal Reserve, U.S. Treasury and other governmental and regulatory bodies, to stabilize or reform the financial markets may not achieve their intended effects and may adversely affect our business.

The U.S. Government, including the U.S. Congress, U.S. Federal Reserve, U.S. Treasury and other governmental and regulatory bodies have from time to time taken actions designed to stabilize and reform the financial markets. In recent years, these activities have included the Federal Reserve’s quantitative easing programs. There can be no assurance that, in the long term, these or any future actions, initiatives or regulatory efforts will improve the efficiency and stability of the mortgage markets or U.S. financial markets. To the extent the mortgage or financial markets do not respond favorably to any of these actions or such actions do not achieve their intended effect, our business, financial condition and results of operations may be adversely affected. We cannot predict whether or when additional actions, initiatives, or regulatory efforts to stabilize and stimulate the economy and the financial markets may occur or the potential impact to our business, financial condition and results of operations.

Risks Related To Our Credit Assets

We invest in securities in the credit risk transfer sector that are subject to mortgage credit risk.

We invest in securities in the credit risk transfer (“CRT”) sector. The CRT sector is comprised of the risk sharing transactions issued by Fannie Mae (“CAS”) and Freddie Mac (“STACR”), and similarly structured transactions arranged by third party market participants. The securities issued in the CRT sector are designed to synthetically transfer mortgage credit risk from Fannie Mae and Freddie Mac to private investors. Currently, CAS and STACR transactions are structured as unsecured and unguaranteed bonds issued by Fannie Mae or Freddie Mac, respectively, whose principal payments are determined by the delinquency and prepayment experience of a reference pool of mortgages guaranteed by Fannie Mae or Freddie Mac, respectively, in a particular quarter. Transactions arranged by third party market participants in the CRT sector are similarly structured to reference a specific pool of loans that have been securitized by Fannie Mae or Freddie Mac and synthetically transfer mortgage credit risk related to those loans to the purchaser of the securities. The holder of the securities in the CRT sector has the risk that the borrowers may default on their obligations to make full and timely payments of principal and interest. Investments in securities in the CRT sector could cause us to incur losses of income from, and/or losses in market value relating to, these assets if there are defaults of principal and/or interest on the pool of mortgages referenced in the transaction.

A prolonged economic slowdown or declining real estate values could impair the assets we may own and adversely affect our operating results.

Our non-Agency mortgage-backed securities, mortgage loans, and mortgage loans for which we own the servicing rights, along with our commercial real estate debt, preferred equity, and real estate assets may be susceptible to economic

slowdowns or recessions, which could lead to financial losses in our assets and a decrease in revenues, net income and asset values.
Owners of Agency mortgage-backed securities are protected from the risk of default on the underlying mortgages by guarantees from Fannie Mae, Freddie Mac or, in the case of the Ginnie Mae, the U.S. Government. However, we also acquire CRTs and non-Agency mortgage-backed securities, which are backed by residential real property but, in contrast to Agency mortgage-backed securities, the principal and interest payments are not guaranteed by GSEs or the U.S. Government. Our CRT and non-Agency mortgage-backed securities investments are therefore particularly sensitive to recessions and declining real estate values.

In the event of a default on one of our commercial mortgage loans or other commercial real estate debt or residential mortgage loans that we hold in our portfolio or a mortgage loan underlying CRT or non-Agency mortgage-backed securities in our portfolio, we bear the risk of loss as a result of the potential deficiency between the value of the collateral and the debt owed, as well as the costs and delays of foreclosure or other remedies, and the costs of maintaining and ultimately selling a property after foreclosure. Delinquencies and defaults on mortgage loans for which we own the servicing rights will adversely affect the amount of servicing fee income we receive and may result in increased servicing costs and operational risks due to the increased complexity of servicing delinquent and defaulted mortgage loans. If an investor in the mortgage loans for which we own the servicing rights determines that the rate of delinquencies or defaults for the loans it owns is unacceptable, we bear the risk of losing the right to service the related mortgage loans which could adversely affect our revenues, business prospects and financial condition.

Geographic concentration exposes investors to greater risk of default and loss.
Repayments by borrowers and the market value of the related assets could be affected by economic conditions generally or specific to geographic areas or regions of the United States, and concentrations of mortgaged commercial and residential properties in particular geographic areas may increase the risk that adverse economic or other developments or natural or man-made disasters affecting a particular region of the country could increase the frequency and severity of losses on mortgage loans or other real estate debt secured by those properties. From time to time, regions of the United States experience significant real estate downturns when others do not. Regional economic declines or conditions in regional real estate markets could adversely affect the income from, and market value of, the mortgaged properties. In addition, local or regional economies may be adversely affected to a greater degree than other areas of the country by developments affecting industries concentrated in such area. A decline in the general economic condition in the region in which mortgaged properties securing the related mortgage

loans are located would result in a decrease in consumer demand in the region, and the income from and market value of the mortgaged properties may be adversely affected.

Other regional factors – e.g., earthquakes, floods, forest fires, hurricanes or changes in governmental rules or fiscal policies – also may adversely affect the mortgaged properties. Assets in certain regional areas may be more susceptible to certain hazards (such as earthquakes, widespread fires, floods or hurricanes) than properties in other parts of the country and collateral properties located in coastal states may be more susceptible to hurricanes than properties in other parts of the country. As a result, areas affected by such events often experience disruptions in travel, transportation and tourism, loss of jobs and an overall decrease in consumer activity, and often a decline in real estate-related investments. There can be no assurance that the economies in such impacted areas will recover sufficiently to support income producing real estate at pre-event levels or that the costs of the related clean-up will not have a material adverse effect on the local or national economy.

Inadequate property insurance coverage could have an adverse impact on our operating results.

Commercial and residential real estate assets may suffer casualty losses due to risks (including acts of terrorism) that are not covered by insurance or for which insurance coverage requirements have been contractually limited by the related loan documents. Moreover, if reconstruction or major repairs are required following a casualty, changes in laws that have occurred since the time of original construction may materially impair the borrower's ability to effect such reconstruction or major repairs or may materially increase the cost thereof.

There is no assurance that borrowers have maintained or will maintain the insurance required under the applicable loan documents or that such insurance will be adequate. In addition, since the residential mortgage loans generally do not require maintenance of terrorism insurance, we cannot assure you that any property will be covered by terrorism insurance. Therefore, damage to a collateral property caused by acts of terror may not be covered by insurance and may result in substantial losses to us.

We may incur losses when a borrower defaults on a loan and the underlying collateral value is less than the amount due.

If a borrower defaults on a non-recourse loan, we will only have recourse to the real estate-related assets collateralizing the loan. If the underlying collateral value is less than the loan amount, we may suffer a loss. Conversely, some of our loans may be unsecured or are secured only by equity interests in the borrowing entities. These loans are subject to the risk that other lenders in the capital stack may be directly secured by the real estate assets of the borrower or may otherwise have a superior right to repayment. Upon a default, those

collateralized senior lenders would have priority over us with respect to the proceeds of a sale of the underlying real estate. In cases described above, we may lack control over the underlying asset collateralizing our loan or the underlying assets of the borrower before a default, and, as a result, the value of the collateral may be reduced by acts or omissions by owners or managers of the assets. In addition, the value of the underlying real estate may be adversely affected by some or all of the risks referenced above with respect to our owned real estate.
Some of our loans may be backed or supported by individual or corporate guarantees from borrowers or their affiliates that are not secured. If the guarantees are not fully or partially secured, we typically rely on financial covenants from borrowers and guarantors that are designed to require the borrower or guarantor to maintain certain levels of creditworthiness. Where we do not have recourse to specific collateral pledged to satisfy such guarantees or recourse loans, we will only have recourse as an unsecured creditor to the general assets of the borrower or guarantor, some or all of which may be pledged as collateral for other lenders. There can be no assurance that a borrower or guarantor will comply with its financial covenants, or that sufficient assets will be available to pay amounts owed to us under our loans and guarantees. As a result of these factors, we may suffer additional losses that could have a material adverse effect on our financial performance.
Upon a borrower bankruptcy, we may not have full recourse to the assets of the borrower to satisfy our loan. In addition, certain of our loans are subordinate to other debt. If a borrower defaults on our loan or on debt senior to our loan, or upon a borrower bankruptcy, our loan will be satisfied only after the senior debt holder receives payment. Where debt senior to our loan exists, the presence of intercreditor arrangements may limit our ability to amend our loan documents, assign our loans, accept prepayments, exercise our remedies (through “standstill” periods) and control decisions made in bankruptcy proceedings. Bankruptcy and borrower litigation can significantly increase collection costs and the time needed for us to acquire title to the underlying collateral (if applicable), during which time the collateral and/or a borrower’s financial condition may decline in value, causing us to suffer additional losses.
If the value of collateral underlying a loan declines or interest rates increase during the term of a loan, a borrower may not be able to obtain the necessary funds to repay our loan at maturity through refinancing because the underlying property revenue cannot satisfy the debt service coverage requirements necessary to obtain new financing. If a borrower is unable to repay our loan at maturity, we could suffer additional loss that may adversely impact our financial performance.
Our assets may become non-performing or sub-performing assets in the future, which are subject to increased risks relative to performing loans.

Our assets may in the near or the long term become non-performing or sub-performing assets, which are subject to increased risks relative to performing assets. Commercial loans and residential mortgage loans may become non-performing or sub-performing for a variety of reasons that result in the borrower being unable to meet its debt service and/or repayment obligations, such as the underlying property being too highly leveraged, the financial distress of the borrower, or in the case of a commercial loan, decreasing income generated from the underlying property. Such non-performing or sub-performing assets may require a substantial amount of workout negotiations and/or restructuring, which may involve substantial cost and divert the attention of our management from other activities and may entail, among other things, a substantial reduction in interest rate, the capitalization of interest payments and a substantial write-down of the principal of the loan. Even if a restructuring were successfully accomplished, the borrower may not be able or willing to maintain the restructured payments or refinance the restructured loan upon maturity.
From time to time we may find it necessary or desirable to foreclose on loans we acquire or originate, and the foreclosure process may be lengthy and expensive. Borrowers may resist foreclosure actions by asserting numerous claims, counterclaims and defenses to payment against us (such as lender liability claims and defenses) even when such assertions may have no basis in fact or law, in an effort to prolong the foreclosure action and force the lender into a modification of the loan or a favorable buy-out of the borrower’s position. In some states, foreclosure actions can take several years or more to litigate. At any time prior to or during the foreclosure proceedings, the borrower may file

for bankruptcy, which would have the effect of staying the foreclosure actions and further delaying the resolution of our claims. Foreclosure may create a negative public perception of the related property, resulting in a diminution of its value. Even if we are successful in foreclosing on a loan, the liquidation proceeds upon sale of the underlying real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Furthermore, any costs or delays involved in the foreclosure of a loan or a liquidation of the underlying property will further reduce the proceeds and thus increase our loss. Any such reductions could materially and adversely affect the value of the commercial loans in which we invest.

Whether or not we have participated in the negotiation of the terms of a loan, there can be no assurance as to the adequacy of the protection of the terms of the loan, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests. Furthermore, claims may be asserted that might interfere with enforcement of our rights. In the event of a foreclosure, we may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of that real estate may not be sufficient to recover our cost basis in the loan, resulting in a loss to us. Any costs or delays involved in the effectuation of a foreclosure of the loan or a

liquidation of the underlying property will further reduce the proceeds and increase our loss.
Whole loan mortgages are also subject to “special hazard” risk (property damage caused by hazards, such as earthquakes or environmental hazards, not covered by standard property insurance policies), and to bankruptcy risk (reduction in a borrower’s mortgage debt by a bankruptcy court). In addition, claims may be assessed against us on account of our position as mortgage holder or property owner, as applicable, including responsibility for tax payments, environmental hazards and other liabilities, which could have a material adverse effect on our results of operations, financial condition and our ability to make distributions to our stockholders.

We may be required to repurchase commercial or residential mortgage loans or indemnify investors if we breach representations and warranties, which could have a negative impact on our earnings.

When we sell or securitize loans, we will be required to make customary representations and warranties about such loans to the loan purchaser. Our mortgage loan sale agreements will require us to repurchase or substitute loans in the event we breach a representation or warranty given to the loan purchaser. In addition, we may be required to repurchase loans as a result of borrower fraud or in the event of early payment default on a mortgage loan. Likewise, we may be required to repurchase or substitute loans if we breach a representation or warranty in connection with our securitizations. The remedies available to a purchaser of mortgage loans are generally broader than those available to us against the originating broker or correspondent. Further, if a purchaser enforces its remedies against us, we may not be able to enforce the remedies we have against the sellers. The repurchased loans typically can only be financed at a steep discount to their repurchase price, if at all. They are also typically sold at a significant discount to the unpaid principal balance. Significant repurchase activity could adversely affect our cash flow, results of operations, financial condition and business prospects.

Our and our third party service providers’ and servicers’ due diligence of potential assets may not reveal all of the liabilities associated with such assets and may not reveal other weaknesses in such assets, which could lead to losses.

Before acquiring a commercial or residential real estate debt asset, we will assess the strengths and weaknesses of the borrower, originator or issuer of the asset as well as other factors and characteristics that are material to the performance of the asset. In making the assessment and otherwise conducting customary due diligence, we will rely on resources available to us, including our third party service providers and servicers. This process is particularly important with respect to newly formed originators or issuers because there may be little or no information publicly available about these entities and assets. There can be no

assurance that our due diligence process will uncover all relevant facts or that any asset acquisition will be successful.

When we foreclose on an asset, we may come to own and operate the property securing the loan, which would expose us to the risks inherent in that activity.

When we foreclose on a commercial or residential real estate asset, we may take title to the property securing that asset, and if we do not or cannot sell the property, we would then come to own and operate it as “real estate owned.” Owning and operating real property involves risks that are different (and in many ways more significant) than the risks faced in owning an asset secured by that property. In addition, we may end up owning a property that we would not otherwise have decided to acquire directly at the price of our original investment or at all. Further, some of the properties underlying the assets we are acquiring are of a different type or class than property we have had experience owning directly, including properties such as hotels. Accordingly, we may not manage these properties as well as they might be managed by another owner, and our returns to investors could suffer. If we foreclose on and come to own property, our financial performance and returns to investors could suffer.

Financial covenants could adversely affect our ability to conduct our business.

The commercial mortgages on our equity properties generally contain customary negative covenants that limit our ability to further mortgage the properties, to enter into material leases or other agreements or materially modify existing leases or other agreements without lender consent, to access cash flow in certain circumstances, and to discontinue insurance coverage, among other things. These restrictions could adversely affect operations, and our ability to pay debt obligations. In addition, in some instances guaranties given as further security for these mortgage loans contain affirmative covenants to maintain a minimum net worth and liquidity.

Proposals to acquire mortgage loans by eminent domain may adversely affect the value of our assets.

Local governments have taken steps to consider how the power of eminent domain could be used to acquire residential mortgage loans and there can be no certainty whether any mortgage loans sought to be purchased will be mortgage loans held in securitization trusts and what purchase price would be paid for any such mortgage loans. Any such actions could have a material adverse effect on the market value of our mortgage-backed securities, mortgage loans and MSRs. There is also no certainty as to whether any such action without the consent of investors would face legal challenge, and, if so, the outcome of any such challenge.

Our investments in corporate loans and debt securities for middle market companies carry risks.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 1A. Risk Factors

We invest a percentage of our assets directly in the ownership of corporate loans and debt securities for middle market companies, and we expect our investments in this space to grow in 2018. Non-investment grade or unrated loans to middle market businesses may carry more inherent risks than larger, investment grade publicly traded entities. These middle market companies generally have less access to public capital markets, and generally have higher financing costs. Such companies, particularly in an economic slowdown or recession, may be in a weaker financial position, may need more capital to expand or compete, and may be unable to obtain financing from their respective private capital providers, public capital markets or from traditional sources, such as commercial banks. In an economic downturn, middle market loan obligors, which may be highly leveraged, may be unable to meet their debt service requirements. Middle market businesses may have narrower product lines, be more vulnerable to exogenous events and maintain smaller market shares than large businesses. Therefore, they may be more vulnerable to competitors' actions and market conditions, as well as general economic downturns. Middle market businesses may have more difficulties implementing enterprise resource plans and may face greater challenges integrating acquisitions than large businesses. These businesses may also experience variations in operating results. The success of a middle market company may depend on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons may have a material adverse impact on such middle market company and its ability to repay its obligations. A deterioration in the value of our investments in corporate loans and debt securities for middle market companies could have an adverse impact on our results of operations.

Risks Related To Commercial Real Estate Debt, Preferred Equity Investments, Net Lease Real Estate Assets and Other Equity Ownership of Real Estate Assets
The real estate assets we acquire are subject to risks particular to real property, which may adversely affect our returns from certain assets and our ability to make distributions to our stockholders.

We own assets secured by real estate and own real estate directly through direct purchases or realization or upon a default of mortgage loans. Real estate assets are subject to various risks, including:

- acts of God, including earthquakes, hurricanes, floods and other natural disasters, which may result in uninsured losses;
- acts of war or terrorism, including the consequences of terrorist attacks;
- adverse changes in national and local economic and market conditions;
- changes in governmental laws and regulations, fiscal policies and zoning ordinances and the

related costs of compliance with laws and regulations, fiscal policies and ordinances;
- the potential for uninsured or under-insured property losses; and
- environmental conditions of the real estate.

Under various U.S. federal, state and local environmental laws, ordinances and regulations, a current or previous owner of real estate (including, in certain circumstances, a secured lender that succeeds to ownership or control of a property) may become liable for the costs of removal or remediation of certain hazardous or toxic substances at, on, under or in its property.

If any of these or similar events occurs, it may reduce our return from an affected property or investment and reduce or eliminate our ability to make distributions to stockholders.

The commercial loan assets we originate and/or acquire depend on the ability of the property owner to generate net income from operating the property. Failure to do so may result in delinquency and/or foreclosure.

Commercial loans are secured by real property and are subject to risks of delinquency and foreclosure, and risks of loss that may be greater than similar risks associated with loans made on the security of single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the income of the property is reduced, the borrower's ability to repay the loan may be impaired. The income of an income-producing property can be adversely affected by, among other things,

- changes in national, regional or local economic conditions or specific industry segments, including the credit and securitization markets;
- declines in regional or local real estate values;
- declines in regional or local rental or occupancy rates;
- increases in interest rates, real estate tax rates and other operating expenses;
- tenant mix;
- success of tenant businesses and the tenant's ability to meet their lease obligations;
- property management decisions;
- property location, condition and design;
- competition from comparable types of properties;
- changes in laws that increase operating expenses or limit rents that may be charged;
- costs of remediation and liabilities associated with environmental conditions;
- the potential for uninsured or underinsured property losses;
- changes in governmental laws and regulations, including fiscal policies, zoning ordinances and

environmental legislation and the related costs of compliance;
- acts of God, terrorist attacks, social unrest and civil disturbances;
- litigation and condemnation proceedings regarding the properties; and
- bankruptcy proceedings.

In the event of any default under a loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest (and other unpaid sums) under the loan, which could have a material adverse effect on our cash flow from operations and limit amounts available for distribution to our stockholders. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Workouts and/or foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on our anticipated return on the foreclosed mortgage loan.

Commercial and non-Agency mortgage-backed securities we acquire may be subject to losses.

In general, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by the holder of a mezzanine loan or B-Note, if any, then by the “first loss” subordinated security holder generally, the “B-Piece” buyer, and then by the holder of a higher-rated security. In the event of default and the exhaustion of any equity support, mezzanine loans or B-Notes, and any classes of securities junior to those that we acquire, we may not be able to recover all of our capital in the securities we purchase. In addition, if the underlying mortgage portfolio has been overvalued by the originator, or if the values subsequently decline, less collateral is available to satisfy interest and principal payments due on the related mortgage-backed securities. The prices of lower credit quality mortgage-backed securities are generally less sensitive to interest rate changes than more highly rated mortgage-backed securities, but more sensitive to adverse economic downturns or individual issuer developments. The projection of an economic downturn, for example, could cause a decline in the price of lower credit quality mortgage-backed securities because the ability of obligors of mortgages underlying mortgage-backed securities to make principal and interest payments may be impaired. In such event, existing credit support in the securitization structure may be insufficient to protect us against loss of our principal and interest on these securities.

Borrowers May Be Unable To Repay the Remaining Principal Balance on the Maturity Date.

Many commercial loans are non-amortizing balloon loans that provide for substantial payments of principal due at their stated maturities. Commercial loans with substantial remaining principal balances at their stated maturity date involve greater risk than fully-amortizing loans. This is because the borrower may be unable to repay the loan at that time.
A borrower’s ability to repay a mortgage loan on its stated maturity date typically will depend upon its ability either to refinance the mortgage loan or to sell the mortgaged property at a price sufficient to permit repayment. A borrower’s ability to achieve either of these goals will be affected by a number of factors, including:
- the availability of, and competition for, credit for commercial real estate projects, which fluctuate over time;
- the prevailing interest rates;
- the net operating income generated by the related mortgaged properties;
- the fair market value of the related mortgaged properties;
- the borrower’s equity in the related mortgaged properties;
- significant tenant rollover at the related mortgaged properties;

- the borrower's financial condition;
- the operating history and occupancy level of the related mortgaged properties;
- reductions in applicable government assistance/rent subsidy programs;
- changes in zoning or tax laws;
- changes in competition in the relevant location;
- changes in rental rates in the relevant location;
- changes in government regulation and fiscal policy;
- the state of fixed income and mortgage markets;
- the availability of credit for multi-family and commercial properties;
- prevailing general and regional economic conditions; and
- the availability of funds in the credit markets which fluctuates over time.

Whether or not losses are ultimately sustained, any delay in the collection of a balloon payment on the maturity date will likely extend the weighted average life of our investment.

The B-Notes that we originate and acquire may be subject to additional risks related to the privately negotiated structure and terms of the transaction, which may result in losses to us.

We may originate and acquire B-Notes. A B-Note is a mortgage loan typically (1) secured by a first mortgage on a single large commercial property or group of related properties and (2) subordinated to an A-Note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for B-Note holders after payment to the A-Note holders. However, because each transaction is privately negotiated, B-Notes can vary in their structural characteristics and risks. For example, the rights of holders of B-Notes to control the process following a borrower default may vary from transaction to transaction. Further, B-Notes may be secured by a single property and so reflect the risks associated with significant concentration. Significant losses related to our B-Notes would result in operating losses for us and may limit our ability to make distributions to our stockholders.

The mezzanine loan assets and other subordinate debt positions that we originate and acquire involve greater risks of loss than senior loans.

We originate and acquire mezzanine loans, which take the form of subordinated loans secured by a pledge of the ownership interests by the entity that owns the interest in the entity owning the real property. We also make commercial real estate preferred equity investments, which, unlike mezzanine loans, are generally not secured by a pledge of equity interests and may be less liquid investments. Although as a holder of preferred equity we may protect our position with covenants that limit the activities of the entity in which we hold an interest and protect our equity by obtaining a contractual right to control the underlying property or force a sale after an event of default, should such a default occur, we would only be able to proceed against the entity in which we hold an interest, and not the real property owned by such entity and ultimately underlying the investment. These types of subordinate debt assets involve a higher degree of risk than senior mortgage lending secured by income-producing real property, because the loan may become unsecured or unrecoverable as a result of foreclosure by the senior lender on its mortgage or the exercise of remedies by a lender holding a mezzanine loan that is senior to our subordinate debt. In the event of a bankruptcy of the entity providing the pledge of ownership interests as security for a mezzanine loan, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan, preferred equity investment, or debt senior to our loan, or in the event of a borrower bankruptcy, our subordinate debt will be satisfied only after the senior debt. As a result, we may not recover some or all of our initial investment. In addition, mezzanine loans and preferred equity investments may have higher loan-to-value ratios than conventional mortgage loans, resulting in the borrower having less equity in the property and increasing the risk of loss of principal. Further, any subordinate debt investment may give rise to sudden liquidity needs in order for us to protect our position. Significant losses related to our mezzanine loans and/or preferred equity positions would result in operating losses for us and may limit our ability to make distributions to our stockholders.

We are subject to additional risks associated with loan participations and co-lending arrangements.

Some of our loans may be participation interests or co-lender arrangements in which we share the rights, obligations and benefits of the loan with other lenders. We may need the consent of these parties to exercise our rights under such loans, including rights with respect to amendment of loan documentation, enforcement proceedings upon a default and the institution of, and control over, foreclosure proceedings. Similarly, certain participants may be able to take actions to which we object but to which we will be bound if our participation interest represents a minority interest. We may be adversely affected by this lack of control.

Construction loans involve an increased risk of loss.

We have in the past and may in the future acquire and/or originate construction loans. If we fail to fund our entire commitment on a construction loan or if a borrower otherwise fails to complete the construction of a project, there could be adverse consequences associated with the loan, including: a loss of the value of the property securing the loan, especially if the borrower is unable to raise funds to complete it from other sources; a borrower claim against us for failure to perform under the loan documents; increased costs to the borrower that the borrower is unable to pay; a bankruptcy filing by the borrower; and abandonment by the borrower of the collateral for the loan.

If we do not have an adequate completion guarantee, risks of cost overruns and non-completion of renovation of the properties underlying rehabilitation loans may result in significant losses. The renovation, refurbishment or expansion of a mortgaged property by a borrower involves risks of cost overruns and non-completion. Estimates of the costs of improvements to bring an acquired property up to standards established for the market position intended for that property may prove inaccurate. Other risks may include rehabilitation costs exceeding original estimates, possibly making a project uneconomical, environmental risks and rehabilitation and subsequent leasing of the property not being completed on schedule. If such renovation is not completed in a timely manner, or if it costs more than expected, the borrower may experience a prolonged impairment of net operating income and may not be able to make payments on our investment, which could result in significant losses.
We may experience losses if the creditworthiness of our tenants deteriorates and they are unable to meet their lease obligations.

We own properties leased to tenants and receive rents from tenants during the contracted term of such leases. A tenant's ability to pay rent is determined by its creditworthiness, among other factors. If a tenant's credit deteriorates, the tenant may default on its obligations under our lease and may also become bankrupt. The bankruptcy or insolvency of our tenants or other failure to pay is likely to adversely affect the income produced by our real estate assets. If a tenant defaults, we may experience delays and incur substantial costs in enforcing our rights as landlord. If a tenant files for bankruptcy, we may not be able to evict the tenant solely because of such bankruptcy or failure to pay. A court, furthermore, may authorize a tenant to reject and terminate its lease with us. In such a case, our claim against the tenant for unpaid, future rent would be subject to a statutory cap that might be substantially less than the remaining rent owed under the lease. In addition, certain amounts paid to us within 90 days prior to the tenant's bankruptcy filing could be required to be returned to the tenant's bankruptcy estate. In any event, it is highly unlikely that a bankrupt or insolvent tenant would pay in full amounts it owes us under a lease that it intends to reject. In other circumstances, where a tenant's financial condition has become impaired, we may agree to partially or wholly terminate the lease in advance of the termination date in consideration for a lease termination fee that is likely less than the total contractual rental amount. Without regard to the manner in which the lease termination occurs, we are likely to incur additional costs in the form of tenant improvements and leasing commissions in our efforts to lease the space to a new tenant. In any of the foregoing circumstances, our financial performance could be materially adversely affected.

Lease expirations, lease defaults and lease terminations may adversely affect our revenue.

Lease expirations and lease terminations may result in reduced revenues if the lease payments received from replacement tenants are less than the lease payments received from the expiring or terminating tenants. In addition, lease defaults or lease terminations by one or more significant tenants or the failure of tenants under expiring leases to elect to renew their leases, could cause us to experience long periods of vacancy with no revenue from a facility and to incur substantial capital expenditures and/or lease concessions to obtain replacement tenants.

The real estate investments we currently own and expect to acquire will be illiquid.

Because real estate investments are relatively illiquid, our ability to adjust the portfolio promptly in response to economic or other conditions will be limited. Certain significant expenditures generally do not change in response to economic or other conditions, including: (i) debt service (if any), (ii) real estate taxes, and (iii) operating and maintenance costs. This combination of variable revenue and relatively fixed expenditures may result, under certain market conditions, in reduced earnings and could have an adverse effect on our financial condition.

We may not control the special servicing of the mortgage loans included in the commercial mortgage-backed securities in which we invest and, in such cases, the special

servicer may take actions that could adversely affect our interests.

With respect to the commercial mortgage-backed securities in which we may invest, overall control over the special servicing of the related underlying mortgage loans will be held by a "directing certificate holder" or a "controlling class representative," which is appointed by the holders of the most subordinate class of commercial mortgage-backed securities in such series. To the extent that we acquire classes of existing series of commercial mortgage-backed securities originally rated AAA, we will not have the right to appoint the directing certificate holder. In connection with the servicing of the specially serviced mortgage loans, the related special servicer may, at the direction of the directing certificate holder, take actions with respect to the specially serviced mortgage loans that could adversely affect our interests.

Joint venture investments could be adversely affected by our lack of sole decision-making authority and reliance upon a co-venturer's financial condition.

We co-invest with third parties through joint ventures. Although we generally retain control and decision-making authority in a joint venture relationship, in some circumstances (such as major decisions) we may not be permitted to exercise sole decision-making authority regarding such joint venture or the subject property. Investments in joint ventures may involve risks not present were a third party not involved, including the possibility that co-venturers might become bankrupt or otherwise fail to fund their share of required capital contributions. Additionally, our co-venturers might at any time have economic or other business interests or goals which are inconsistent with our business interests or goals, and we may in certain circumstances be liable for the actions of our co-venturers. Consequently, actions by any such co-venturer might result in subjecting properties owned by the joint venture to additional risk, although these risks are mitigated by transaction structure and the terms and conditions of agreements governing the relationship.

Risks Related To Our Residential Credit Business

Our investments in non-Agency mortgage-backed securities (including re-performing loans (“RPL”) / non-performing loans (“NPL”) which we have acquired in recent periods) or other investment assets of lower credit quality, including our investments in seasoned re-performing and non-performing residential whole loans, involve credit risk, which could materially adversely affect our results of operations.

Our current investment strategy includes seeking growth in our residential credit business. The holder of a mortgage or mortgage-backed securities assumes the risk that the related borrowers may default on their obligations to make full and timely payments of principal and interest. Under our investment policy, we have the ability to acquire non-Agency mortgage-backed securities, residential whole loans and other investment assets of lower credit quality. In general, non-Agency mortgage-backed securities carry greater investment risk than Agency mortgage-backed securities because they are not guaranteed as to principal or interest by the U.S. Government, any federal agency or any federally chartered corporation. Non-investment grade, non-Agency securities tend to be less liquid, may have a higher risk of default and may be more difficult to value than investment grade bonds. Higher-than-expected rates of default and/or higher-than-expected loss severities on the mortgages underlying our non-Agency mortgage-backed securities or on our residential whole loan investments may adversely affect the value of those assets. Accordingly, defaults in the payment of principal and/or interest on our non-Agency mortgage-backed securities, residential whole loan investments and other investment assets of less-than-high credit quality would likely result in our incurring losses of income from, and/or losses in market value relating to, these assets.

We have investments in non-Agency mortgage-backed securities collateralized by Alt A loans and may also have investments collateralized by subprime mortgage loans, which, due to lower underwriting standards, are subject to increased risk of losses.

We have certain investments in non-Agency mortgage-backed securities backed by collateral pools containing mortgage loans that were originated under underwriting standards that were less strict than those used in underwriting "prime mortgage loans." These lower standards permitted mortgage loans, often with LTV ratios in excess of 80%, to be made to borrowers having impaired credit histories, lower credit scores, higher debt-to-income ratios and/or unverified income. Difficult economic conditions, including increased interest rates and lower home prices, can result in Alt A and subprime mortgage loans having increased rates of delinquency, foreclosure, bankruptcy and loss (including such as during the credit crisis of 2007-2008 and the housing crisis that followed), and are likely to otherwise experience delinquency, foreclosure, bankruptcy and loss rates that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in a more traditional manner. Thus, because of higher delinquency rates and losses associated with Alt A and subprime mortgage loans, the performance of our non-Agency mortgage-backed securities that are backed by these types of loans could be correspondingly adversely affected, which could materially adversely impact our results of operations, financial condition and business.

Our investments may include subordinated tranches of non-Agency mortgage-backed securities, which are subordinate in right of payment to more senior securities.

Our investments may include subordinated tranches of non-Agency mortgage-backed securities, which are subordinated classes of securities in a structure of securities collateralized

by a pool of mortgage loans and, accordingly, are the first or among the first to bear the loss upon a restructuring or liquidation of the underlying collateral and the last to receive payment of interest and principal. Additionally, estimated fair values of these subordinated interests tend to be more sensitive to changes in economic conditions than more senior securities. As a result, such subordinated interests generally are not actively traded and may not be liquid investments.

We are subject to counterparty risk and may be unable to seek indemnity or require counterparties to repurchase residential whole loans if they breach representations and warranties, which could cause us to suffer losses.

When selling mortgage loans, sellers typically make customary representations and warranties about such loans. Residential mortgage loan purchase agreements may entitle the purchaser of the loans to seek indemnity or demand repurchase or substitution of the loans in the event the seller of the loans breaches a representation or warranty given to the purchaser. There can be no assurance that a mortgage loan purchase agreement will contain appropriate representations and warranties, that we or the trust that purchases the mortgage loans would be able to enforce a contractual right to repurchase or substitution, or that the seller of the loans will remain solvent or otherwise be able to honor its obligations under its mortgage loan purchase agreements. The inability to obtain or enforce an indemnity or require repurchase of a significant number of loans could adversely affect our results of operations, financial condition and business.

Our investments in residential whole loans subject us to servicing-related risks, including those associated with foreclosure.

We may acquire residential whole loans that we purchase together with the related MSRs. We rely on unaffiliated servicing companies to service and manage the mortgages underlying our Non-Agency mortgage-backed securities and our residential whole loans. If a servicer is not vigilant in seeing that borrowers make their required monthly payments, borrowers may be less likely to make these payments, resulting in a higher frequency of default. If a servicer takes longer to liquidate non-performing mortgages, our losses related to those loans may be higher than originally anticipated.

Any failure by servicers to service these mortgages and related real estate owned ("REO") properties could negatively impact the value of these investments and our financial performance. In addition, while we have contracted, and will continue to contract, with unaffiliated servicing companies to carry out the actual servicing of the loans (including all direct interface with the borrowers), we are nevertheless ultimately responsible, vis-à-vis the borrowers and state and federal regulators, for ensuring that the loans are serviced in accordance with the terms of the related notes and mortgages and applicable law and regulation. In light of the current regulatory environment, such exposure could be significant even though we might have contractual claims against our servicers for any failure to service the loans to the required standard.

When a residential whole loan we own is foreclosed upon, title to the underlying property would be taken by one of our subsidiaries. The foreclosure process, especially in judicial foreclosure states such as New York, Florida and New Jersey can be lengthy and expensive, and the delays and costs involved in completing a foreclosure, and then liquidating the property through sale, may materially increase any related loss. Finally, at such time as title is taken to a foreclosed property, it may require more extensive rehabilitation than we estimated at acquisition or a previously unknown environmental liability may be discovered that would require expensive and time-consuming remediation.

Challenges to the MERS® System could materially and adversely affect our business, results of operations and financial condition.

MERSCORP, Inc. is a privately held company that maintains an electronic registry, referred to as the MERS System, that tracks ownership of residential mortgage loans in the U.S., as well as the identity of the associated servicer and subservicer. Mortgage Electronic Registration Systems, Inc., or MERS, a wholly-owned subsidiary of MERSCORP, Inc., can serve as a nominee for the owner of a mortgage loan and in that role initiate foreclosures and/or become the mortgagee of record for the loan in local land records. We, or other parties with whom we contract to do business or from whom we acquire assets, may choose to use MERS as a nominee. The MERS System is widely used by participants throughout the mortgage finance industry.

Over the last several years, there have been legal challenges disputing MERS's legal standing to initiate foreclosures and/or act as nominee in local land records.

It is possible that these challenges could negatively affect MERS's ability to serve as the mortgagee of record in some jurisdictions. In addition, where MERS is the mortgagee of record, it must execute assignments of mortgages, affidavits and other legal documents in connection with foreclosure proceedings. As a result, investigations by governmental authorities and others into a servicer's possible foreclosure process deficiencies may impact MERS. Failures by MERS to apply prudent and effective process controls and to comply with legal and other requirements in the foreclosure process could pose operational, reputational and legal risks that may materially and adversely affect our business, results of operations and financial condition.

With respect to mortgage loans we own, or which we have purchased and subsequently sold, we may be subject to liability for potential violations of truth-in-lending or other similar consumer protection laws and regulations, which could adversely impact our business and financial results.

Federal consumer protection laws and regulations regulate residential mortgage loan underwriting and originators' lending processes, standards, and disclosures to borrowers. These laws and regulations include, among others, the Consumer Financial Protection Bureau's "ability-to-repay" and "qualified mortgage" regulations. In addition, there are various other federal, state, and local laws and regulations that are intended to discourage predatory lending practices by residential mortgage loan originators. For example, the federal Home Ownership and Equity Protection Act of 1994 ("HOEPA") which was expanded under the Dodd Frank Act, prohibits inclusion of certain provisions in residential mortgage loans that have mortgage rates or origination costs in excess of prescribed levels and requires that borrowers be given certain disclosures prior to origination. Some states have enacted, or may enact, similar laws or regulations, which in some cases may impose restrictions and requirements greater than those in place under federal laws and regulations. In addition, under the anti-predatory lending laws of some states, the origination of certain residential mortgage loans, including loans that are classified as "high cost" loans under applicable law, must satisfy a net tangible benefits test with respect to the borrower. This test, as well as certain standards set forth in the "ability-to-repay" and "qualified mortgage" regulations, may be highly subjective and open to interpretation. As a result, a court may determine that a residential mortgage loan did not meet the applicable standard or test even if the originator reasonably believed such standard or test had been satisfied. Failure of residential mortgage loan originators or servicers to comply with federal consumer protection laws and regulations could subject us, as an assignee or purchaser of these loans (or as an investor in securities backed by these loans), to monetary penalties and defenses to foreclosure, including by recoupment or setoff of damages and costs, which for some violations included the sum of all finance charges and fees paid by the consumer, and could result in rescission of the affected residential mortgage loans, which could adversely impact our business and financial results.

Risks Related to Our Relationship with Our Manager

The management agreement was negotiated between related parties and the terms, including fees payable, may not be as favorable to us as if it were negotiated with an unaffiliated third party.

Because the Manager is owned by members of our management, the management agreement was developed by related parties. Although our independent directors, who are responsible for protecting our and our stockholders' interests with regard to the management agreement, had the benefit of external financial and legal advisors, they did not have the benefit of arm's-length advice from our executive officers. The terms of the management agreement, including fees payable, may not reflect the terms we may have received if it was negotiated with an unrelated third party. In addition, particularly as a result of our relationship with the principal owners and employees of the Manager, who are members of our management, our directors may determine that it is in the best interests of our stockholders not to enforce, or to enforce less vigorously, our rights under the management agreement because of our desire to maintain our ongoing relationship with our Manager.

There may be conflicts of interest between us and our
executive officers.

The Manager is owned by members of our management. The owners of the Manager will be entitled to receive any profit from the management fee we pay to our Manager either in the form of distributions by our Manager or increased value of their ownership interests in the Manager. This may cause our management to have interests that conflict with our interests and those of our stockholders.

We are dependent upon the Manager who provides services to us through the management agreement and we may not find suitable replacements for our Manager if the management agreement is terminated or the Manager's key personnel are no longer available to us.

The Manager is responsible for making all of our investment decisions. We believe that the successful implementation of our investment and financing strategies depend upon the experience of certain of the Manager's officers and employees. None of these individuals' continued service is guaranteed. If the management agreement is terminated or these individuals leave the Manager, the Manager or we may be unable to replace them with persons with appropriate experience, or at all, and we may not be able to execute our business plan.

The management fee is payable regardless of our performance.

The Manager receives a management fee from us that is based on a percentage of our stockholders' equity, regardless of the performance of our investment portfolio (except to the extent that performance affects our stockholders' equity). For example, we pay our Manager a management fee for a specific period even if we experienced a net loss during the same period. The Manager's entitlement to substantial nonperformance-based compensation may reduce its incentive to provide attractive risk-adjusted returns for our investment portfolio. This in turn could limit our ability to make distributions to our stockholders and affect the market price of our common stock.

The fee structure of the management agreement may limit the Manager's ability to retain access to its key personnel.

The management agreement does not provide the Manager with an incentive management fee that would pay the Manager additional compensation as a result of meeting or exceeding performance targets. Some of our externally managed competitors pay their managers an incentive management fee, which could enable the manager to provide additional compensation to its key personnel. Thus, the lack of an incentive fee in the management agreement may limit the ability of the Manager to provide key personnel with additional compensation for strong performance, which could adversely affect the Manager's ability to retain these key personnel. If the Manager were not able to retain any of the key personnel that will be providing services to the Manager, it would have to find replacement personnel to provide those services. Those replacement key personnel may not be able to produce the same operating results as the current key personnel.

Conflicts of interest could arise in connection with our executive officers' discharge of fiduciary duties to our stockholders.

Our current executive officers are members or employees of the Manager while continuing to be executive officers of Annaly. Our executive officers, by virtue of their positions, have fiduciary duties to our company and our stockholders. The duties of our executive officers to us and our stockholders may come into conflict with the interests of such officers in their capacities as members or employees of the Manager. If the Manager were to manage any additional entities, our executive officers could face conflicts of interest in allocating their time among us and such additional entities.

Risks Related to Our Taxation as a REIT

Our failure to qualify as a REIT would have adverse tax consequences.

We believe that since 1997 we have qualified for taxation as a REIT for federal income tax purposes under Sections 856 through 860 of the Code. We plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control. For example, to qualify as a REIT, at least 75% of our gross income must come from real estate sources and 95% of our gross income must come from real estate sources and certain other sources that are itemized in the REIT tax laws. We are also required to distribute to stockholders at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service ("IRS") might make changes to the tax laws and regulations, and the courts might issue new rulings that make it more difficult or impossible for us to remain qualified as a REIT.

If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates (at a 35% rate for years prior to 2018 and a 21% rate for 2018 and subsequent years). Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income

taxes and would therefore have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our equity. In addition, the tax law would no longer require us to make distributions to our stockholders.
A REIT that fails the quarterly asset tests for one or more quarters will not lose its REIT status as a result of such failure if either (i) the failure is regarded as a de minimis failure under standards set out in the Code, or (ii) the failure is greater than a de minimis failure but is attributable to reasonable cause and not willful neglect. In the case of a greater than de minimis failure, however, the REIT must pay a tax and must remedy the failure within 6 months of the close of the quarter in which the failure was identified. In addition, the Code provides relief for failures of other tests imposed as a condition of REIT qualification, as long as the failures are attributable to reasonable cause and not willful neglect. A REIT would be required to pay a penalty of $50,000, however, in the case of each failure.
We have certain distribution requirements, which could adversely affect our ability to execute our business plan.
As a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). The required distribution limits the amount we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of the differences between the time we actually receive revenue or pay expenses and the period we report those items for distribution purposes, we may have to borrow funds on a short-term basis to meet the 90% distribution requirement. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a non-deductible 4% excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws. We intend to make distributions to our stockholders to comply with the REIT qualification requirements of the Code.

From time to time, we may generate taxable income greater than our income for financial reporting purposes prepared in accordance with GAAP, or differences in timing between the recognition of taxable income and the actual receipt of cash may occur. For example, if we purchase Agency or non-Agency securities at a discount, we are generally required to accrete the discount into taxable income prior to receiving the cash proceeds of the accreted discount at maturity, and in some cases, potentially recognize the discount in taxable income once such amounts are reflected in our financial statements. If we do not have other funds available in these situations we could be required to (i) borrow funds on unfavorable terms, (ii) sell investments at disadvantageous prices, (iii) distribute our own stock, see below, or (iv)

distribute amounts that would otherwise be invested in future acquisitions to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the REIT distribution requirement and to avoid the corporate income tax and 4% excise tax in a particular year. These scenarios could increase our costs or reduce our stockholders' equity. Thus, compliance with the REIT requirements may hinder our ability to grow, which could adversely affect the value of our common stock.

Conversely, from time to time, we may generate taxable income less than our income for financial reporting purposes due to GAAP and tax accounting differences or, as mentioned above, the timing between the recognition of taxable income and the actual receipt of cash. In such circumstances we may make distributions according to our business plan that are within our wherewithal from an economic or cash management perspective, but that are labeled as return of capital for tax reporting purposes as they are in excess of taxable income in that period.

We may in the future choose to pay dividends in our own stock, in which case the stockholders may be required to pay income taxes in excess of the cash dividends they receive.
We may in the future distribute taxable dividends that are payable in cash or shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full

amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for U.S. federal income tax purposes. As a result, stockholders may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to certain non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect to all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

Limits on ownership of our common stock could have adverse consequences to you and could limit your opportunity to receive a premium on our stock.

To maintain our qualification as a REIT for federal income tax purposes, not more than 50% in value of the outstanding shares of our capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal tax laws to include certain entities). Primarily to facilitate maintenance of our qualification as a REIT for federal income tax purposes, our charter prohibits ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of our common stock and will prohibit ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the number or value of each class of our outstanding common and preferred stock. Our Board, in its sole and absolute discretion, may waive or modify the ownership limit with respect to one or more persons who would not be treated as “individuals” if it is satisfied, that ownership in excess of this limit will not otherwise jeopardize our status as a REIT for federal income tax purposes.

The ownership limit may have the effect of delaying, deferring or preventing a change in control and, therefore, could adversely affect our stockholders’ ability to realize a premium over the then-prevailing market price for our common stock in connection with a change in control.

A REIT cannot invest more than 20% (25% for taxable years prior to 2018) of its total assets in the stock or securities of one or more taxable REIT subsidiaries (“TRSs”); therefore, our TRSs cannot constitute more than 20% (25% for taxable years prior to 2018) of our total assets.

A TRS is a corporation, other than a REIT or a qualified REIT subsidiary, in which a REIT owns stock and with which we jointly elect TRS status. The term also includes a corporate subsidiary in which the TRS owns more than a 35% interest.

A REIT may own up to 100% of the stock of one or more TRSs. A TRS may earn income that would not be qualifying income if it was earned directly by the parent REIT. Overall, at the close of any calendar quarter, no more than 20% (25% for taxable years prior to 2018) of the value of a REIT’s assets may consist of stock or securities of one or more TRSs.

The stock and securities of our TRSs are expected to represent less than 20% (25% for taxable years prior to 2018) of the value of our total assets. Furthermore, we intend to monitor the value of our investments in the stock and securities of our TRSs to ensure compliance with the above-described limitation. We cannot assure you, however, that we will always be able to comply with the limitation so as to maintain REIT status.

TRSs are subject to tax at the regular corporate rates, are not required to distribute dividends, and the amount of dividends a TRS can pay to its parent REIT may be limited by REIT gross income tests.

A TRS must pay income tax at regular corporate rates on any income that it earns. Our TRSs will pay corporate income tax on their taxable income (at a federal income tax rate of 21% beginning in 2018), and their after-tax net income will be available for distribution to us. In certain circumstances, the ability our TRSs to deduct interest expenses for federal income tax may be limited. Such income, however, is not required to be distributed.

Moreover, the annual gross income tests that must be satisfied to ensure REIT qualification may limit the amount of dividends that we can receive from our TRSs and still maintain our REIT status. Generally, not more than 25% of our gross income can be derived from non-real estate related sources, such as dividends from a TRS. If, for any taxable year, the dividends we received from our TRSs, when added to our other items of non-real estate related income, represented more than 25% of our total gross income for the year, we could be denied REIT status, unless we were able to demonstrate, among other things, that our failure of the gross income test was due to reasonable cause and not willful neglect.

The limitations imposed by the REIT gross income tests may impede our ability to distribute assets from our TRSs to us in the form of dividends. Certain asset transfers may, therefore, have to be structured as purchase and sale transactions upon which our TRSs recognize a taxable gain.

If interest accrues on indebtedness owed by a TRS to its parent REIT at a rate in excess of a commercially reasonable rate, or if transactions between a REIT and a TRS are entered into on other than arm’s-length terms, the REIT may be subject to a penalty tax.

If interest accrues on an indebtedness owed by a TRS to its parent REIT at a rate in excess of a commercially reasonable rate, the REIT is subject to tax at a rate of 100% on the excess of (i) interest payments made by a TRS to its parent REIT over (ii) the amount of interest that would have been payable had interest accrued on the indebtedness at a commercially reasonable rate. A tax at a rate of 100% is also imposed on any transaction between a TRS and its parent REIT to the extent the transaction gives rise to deductions to the TRS that are in excess of the deductions that would have been allowable had the transaction been entered into on arm's-length terms. While we will scrutinize all of our transactions with our TRSs in an effort to ensure that we do not become subject to these taxes, there is no assurance that we will be successful. We may not be able to avoid application of these taxes.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, excise taxes, state or local income, property and transfer taxes, such as mortgage recording taxes, and other taxes. In addition, in order to meet the REIT qualification requirements, prevent the recognition of certain types of non-cash income, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through our TRSs or other subsidiary corporations that will be subject to corporate level income tax at regular rates.

Complying with REIT requirements may cause us to forgo otherwise attractive opportunities.

To remain qualified as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts that we distribute to our stockholders and the ownership of our stock. We may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution, and may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make and, in certain cases, to maintain ownership of, certain attractive investments.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

To remain qualified as a REIT, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, U.S. Government securities and qualified real estate assets. The remainder of our investment in securities (other than U.S. Government securities, qualified real estate assets and securities issued by a TRS) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than U.S. Government securities, qualified real estate assets and securities issued by a TRS) can consist of the securities of any one issuer, no more than 20% (25% for the taxable years prior to 2018) of the value of our total assets can be represented by securities of one or more TRSs. If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate from our investment portfolio otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

Liquidation of assets may jeopardize our REIT qualification or create additional tax liability for us.

To remain qualified as a REIT, we must comply with requirements regarding the composition of our assets and our sources of income. If we are compelled to liquidate our investments to repay obligations to our lenders, we may be unable to comply with these requirements, ultimately jeopardizing our qualification as a REIT, or we may be subject to a 100% tax on any resultant gain if we sell assets that are treated as dealer property or inventory.

Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.

The REIT provisions of the Code could substantially limit our ability to hedge our liabilities. Any income from a properly designated hedging transaction we enter into to manage risk of interest rate changes with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, to acquire or carry real estate assets generally does not constitute "gross income" for purposes of the 75% or 95% gross income tests. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we may have to limit our use of advantageous hedging techniques or implement those hedges through our TRSs. This could increase the cost of our hedging activities because our TRSs would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in our TRSs will generally not provide any tax benefit, except for being carried forward against future taxable income in the TRSs.

The failure of a mezzanine loan or similar debt to qualify as a real estate asset could adversely affect our ability to qualify as a REIT.

We invest in mezzanine loans and similar debt (including preferred equity investments that we treat as mezzanine loans for U.S. federal income tax purposes), for which the IRS has provided a safe harbor but not rules of substantive law. Pursuant to the safe harbor, if a mezzanine loan meets certain requirements, it will be treated by the IRS as a real estate asset for purposes of the REIT asset tests, and interest derived from the mezzanine loan will be treated as qualifying mortgage interest for purposes of the REIT 75% income test. We may acquire mezzanine loans or similar debt that do not meet all of the requirements of this safe harbor. In the event we own a mezzanine loan or similar debt that does not meet the safe harbor, the IRS could challenge such loan's treatment as a real estate asset for purposes of the REIT asset and income tests and, if such a challenge were sustained, we could fail to qualify as a REIT.

Qualifying as a REIT involves highly technical and complex provisions of the Code.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT depends on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. In addition, our ability to satisfy the REIT qualification requirements depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for federal income tax purposes.

The tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of structuring CMOs.

The 100% tax on prohibited transactions will limit our ability to engage in transactions, including certain methods of structuring CMOs, which would be treated as prohibited transactions for federal income tax purposes.

The term “prohibited transaction” generally includes a sale or other disposition of property (including mortgage loans, but other than foreclosure property, as discussed below) that is held primarily for sale to customers in the ordinary course of a trade or business by us or by a borrower that has issued a shared appreciation mortgage or similar debt instrument to us. We could be subject to this tax if we were to dispose of or structure CMOs in a manner that was treated as a prohibited transaction for federal income tax purposes.

We intend to conduct our operations at the REIT level so that no asset that we own (or are treated as owning) will be treated as, or as having been, held for sale to customers, and that a sale of any such asset will not be treated as having been in the ordinary course of our business. As a result, we may choose not to engage in certain transactions at the REIT level, and may limit the structures we utilize for our CMO transactions, even though the sales or structures might otherwise be beneficial to us. In addition, whether property is held “primarily for sale to customers in the ordinary course of a trade or business” depends on the particular facts and circumstances. No assurance can be given that any property that we sell will not be treated as property held for sale to customers, or that we can comply with certain safe-harbor provisions of the Code that would prevent such treatment. The 100% tax does not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate rates. We intend to structure our activities to avoid the prohibited transaction tax.

New legislation or administrative or judicial action, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to remain qualified as a REIT.

The present federal income tax treatment of REITs may be modified, possibly with retroactive effect, by legislative, judicial or administrative action at any time, which could affect the federal income tax treatment of an investment in us. The federal income tax rules dealing with REITs constantly are under review by persons involved in the legislative process, the IRS and the U.S. Treasury Department, which results in statutory changes as well as frequent revisions to regulations and interpretations. The recently enacted tax law informally known as the Tax Cuts and Jobs Act (the “TCJA”) significantly changes the U.S.

federal income tax laws applicable to businesses and their owners, including REITs and their stockholders. Technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA may be forthcoming. Future revisions in federal tax laws and interpretations thereof could affect or cause us to change our investments and commitments and affect the tax considerations of an investment in us.

Uncertainty exists with respect to the treatment of our TBAs for purposes of the REIT asset and income tests.

We purchase and sell Agency mortgage-backed securities through TBAs and recognize income or gains from the disposition of those TBAs, through dollar roll transactions or otherwise, and may continue to do so in the future. While there is no direct authority with respect to the qualification of TBAs as real estate assets or U.S. Government securities for purposes of the 75% asset test or the qualification of income or gains from dispositions of TBAs as gains from the sale of real property (including interests in real property and interests in mortgages on real property) or other qualifying income for purposes of the 75% gross income test, we treat our TBAs as qualifying assets for purposes of the REIT asset tests, and we treat income and gains from our TBAs as qualifying income for purposes of the 75% gross income test, based on an opinion of counsel substantially to the effect that (i) for purposes of the REIT asset tests, our ownership of a TBA should be treated as ownership of real estate assets, and (ii) for purposes of the 75% REIT gross income test, any gain recognized by us in connection with the settlement of our TBAs should be treated as gain from the sale or disposition of an interest in mortgages on real property. Opinions of counsel are not binding on the IRS, and no assurance can be given that the IRS will not successfully challenge the conclusions set forth in such opinions. In addition, it must be emphasized that the opinion of counsel is based on various assumptions relating to our TBAs and is conditioned upon fact-based representations and covenants made by our management regarding our TBAs. No assurance can be given that the IRS would not assert that such assets or income are not qualifying assets or income. If the IRS were to successfully challenge the opinion of counsel, we could be subject to a penalty tax or we could fail to remain qualified as a REIT if a sufficient portion of our assets consists of TBAs or a sufficient portion of our income consists of income or gains from the disposition of TBAs.

Dividends payable by REITs generally receive different tax treatment than dividend income from regular corporations.

Qualified dividend income payable to U.S. stockholders that are individuals, trusts and estates is subject to the reduced maximum tax rate applicable to capital gains. Dividends payable by REITs, however, generally are not eligible for the reduced qualified dividend rates. For taxable years beginning after December 31, 2017 and before January 1, 2026, under the TCJA, non-corporate taxpayers may deduct up to 20% of certain pass-through business income, including "qualified

REIT dividends" (generally, dividends received by a REIT shareholder that are not designated as capital gain dividends or qualified dividend income), subject to certain limitations, resulting in an effective maximum U.S. federal income tax rate of 29.6% on such income. Although the reduced U.S. federal income tax rate applicable to qualified dividend income does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our common stock. Tax rates could be changed in future legislation.

Risks of Ownership of Our Common Stock

The market price and trading volume of our shares of common stock may be volatile and issuances of large amounts of shares of our common stock could cause the market price of our common stock to decline.

If we issue a significant number of shares of common stock or securities convertible into common stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock. During 2017, we issued 140,450,700 shares of common stock and 28,800,000 shares of preferred stock, which could become convertible into common stock under limited circumstances related to a change of control of the Company. In 2018, we issued 17,000,000 shares of preferred stock, which could become convertible into common stock under limited circumstances related to a change of control of the Company, and also established an at-the-market sales program for our common stock having an aggregate offering price of up to $1.5 billion.

The market price of our shares of common stock may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our shares of common stock may fluctuate and cause significant price variations to occur. We cannot assure you that the market price of our shares of common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our shares of common stock include those set forth under "Special Note Regarding Forward-Looking Statements" as well as:

- actual or anticipated variations in our quarterly operating results or business prospects;
- changes in our earnings estimates or publication of research reports about us or the real estate industry;
- an inability to meet or exceed securities analysts' estimates or expectations;
- increases in market interest rates;
- hedging or arbitrage trading activity in our shares of common stock;
- capital commitments;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of management personnel;
- actions by institutional stockholders or activist investors;
- speculation in the press or investment community;
- changes in our distribution policy;
- general market and economic conditions; and
- future sales of our shares of common stock or securities convertible into, or exchangeable or exercisable for, our shares of common stock.

Holders of our shares of common stock will be subject to the risk of volatile market prices and wide fluctuations in the market price of our shares of common stock. These factors may cause the market price of our shares of common stock to decline, regardless of our financial condition, results of operations, business or prospects. It is impossible to assure you that the market prices of our shares of common stock will not fall in the future.

Under our charter, we have 2,000,000,000 authorized shares of capital stock, par value of $0.01 per share. Sales of a substantial number of shares of our common stock or other equity-related securities in the public market, or any hedging or arbitrage trading activity that may develop involving our common stock, could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

Our charter does not permit ownership of over 9.8% of our common or preferred stock and attempts to acquire our common or preferred stock in excess of the 9.8% limit are void without prior approval from our Board.

For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the total number or value of each class of our outstanding common or preferred stock. Our charter’s constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock and thus be subject to our charter’s ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the Board shall be void and will result in the shares being transferred by operation of law to a charitable trust.

Provisions contained in Maryland law that are reflected in our charter and bylaws may have anti-takeover effects, potentially preventing investors from receiving a "control premium" for their shares.

Provisions contained in our charter and bylaws, as well as Maryland corporate law, may have anti-takeover effects that delay, defer or prevent a takeover attempt, which may prevent stockholders from receiving a "control premium" for their shares. For example, these provisions may defer or prevent tender offers for our common stock or purchases of large blocks of our common stock, thereby limiting the opportunities for our stockholders to receive a premium for their common stock over then-prevailing market prices. These provisions include the following:

- Ownership limit. The ownership limit in our charter limits related investors including, among other things, any voting group, from acquiring over 9.8% of our common stock or more than 9.8% of our preferred stock without the consent of our Board.
- Preferred Stock. Our charter authorizes our board of directors to issue preferred stock in one or more classes and to establish the preferences and rights of any class of preferred stock issued. These actions can be taken without soliciting stockholder approval.
- Maryland business combination statute. Maryland law restricts the ability of holders of more than 10% of the voting power of a corporation's shares to engage in a business combination with the corporation.
- Maryland control share acquisition statute. Maryland law limits the voting rights of "control shares" of a corporation in the event of a "control share acquisition."

Broad market fluctuations could negatively impact the market price of our shares of common stock.

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performance. These broad market fluctuations could reduce the market price of our shares of common stock. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations, which could lead to a material decline in the market price of our shares of common stock.

We have not established a minimum dividend payment level and cannot assure stockholders of our ability to pay dividends in the future.

We intend to pay quarterly dividends and to make distributions to our stockholders in amounts such that all or substantially all of our taxable income in each year (subject to certain adjustments) is distributed. This enables us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described in this section. All distributions will be made at the discretion of our Board and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board may deem relevant from time to time.

Our reported GAAP financial results differ from the taxable income results that impact our dividend distribution requirements and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Generally, the cumulative net income we report over the life of an asset will be the same for GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for GAAP net income and REIT taxable income that can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported GAAP financial results could materially differ from our determination of taxable income.

Distributions to tax-exempt investors may be classified as unrelated business taxable income.

Neither ordinary nor capital gain distributions with respect to our common stock nor gain from the sale of our common stock are anticipated to constitute unrelated business taxable income to a tax-exempt investor. However, there are certain exceptions to this rule. In particular:

- part of the income and gain recognized by certain qualified employee pension trusts with respect to our common stock may be treated as unrelated business taxable income if shares of our common stock are predominantly held by qualified employee pension trusts, and we are required to rely on a special look-through rule for purposes of meeting one of the REIT ownership tests, and we are not operated in a manner to avoid treatment of such income or gain as unrelated business taxable income;
- part of the income and gain recognized by a tax-exempt investor with respect to our common stock would constitute unrelated business taxable income if the investor incurs debt in order to acquire the common stock;
- part or all of the income or gain recognized with respect to our common stock by social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group legal services plans which are exempt from federal income taxation under the Code may be treated as unrelated business taxable income; and

to the extent that we (or a part of us, or a disregarded subsidiary of ours) are a "taxable mortgage pool," or if we hold residual interests in a real estate mortgage investment conduit, a portion of the distributions paid to a tax-exempt stockholder that is allocable to excess inclusion income may be treated as unrelated business taxable income.

Regulatory Risks

Loss of Investment Company Act exemption from registration would adversely affect us.

We intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act. If we were to become subject to the Investment Company Act, our ability to use leverage would be substantially reduced, and we would be unable to conduct our business as we currently conduct it.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C), as interpreted by the staff of the SEC, requires us to invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" ("Qualifying Real Estate Assets") and at least 80% of our assets in Qualifying Real Estate Assets plus real estate related assets. The assets that we acquire, therefore, are limited by this provision of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act.

We rely on a SEC interpretation that "whole pool certificates" that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae ("Agency Whole Pool Certificates") are Qualifying Real Estate Assets under Section 3(c)(5)(C). This interpretation was promulgated by the SEC staff in a no-action letter over 30 years ago, was reaffirmed by the SEC in 1992 and has been commonly relied upon by mortgage REITs.

On August 31, 2011, the SEC issued a concept release titled "Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments" (SEC Release No. IC-29778). In this concept release, the SEC announced it was reviewing interpretive issues related to the Section 3(c)(5)(C) exemption. Among other things, the SEC requested comments on whether it should revisit whether Agency Whole Pool Certificates may be treated as interests in real estate (and presumably Qualifying Real Estate Assets) and whether companies, such as us, whose primary business consists of investing in Agency Whole Pool Certificates are the type of entities that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C). The potential outcomes of the SEC's actions are unclear as is the SEC's timetable for its review and actions.

If the SEC changes its views regarding which securities are Qualifying Real Estate Assets or real estate related assets, adopts a contrary interpretation with respect to Agency Whole Pool Certificates or otherwise believes we do not satisfy the exemption under Section 3(c)(5)(C), we could be required to restructure our activities or sell certain of our assets. The net effect of these factors will be to lower our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption.

Compliance with proposed and recently enacted changes in securities laws and regulations increases our costs.

The Dodd-Frank Act contains many regulatory changes and calls for future rulemaking that may affect our business, including, but not limited to resolutions involving derivatives, risk-retention in securitizations and short-term financings. We are evaluating, and will continue to evaluate the potential impact of regulatory change under the

Dodd-Frank Act.

Changes in laws or regulations governing our operations or our failure to comply with those laws or regulations may adversely affect our business.

We are subject to regulation by laws at the local, state and federal level, including securities and tax laws and financial accounting and reporting standards. These laws and regulations, as well as their interpretation, may be changed from time to time.

Accordingly, any change in these laws or regulations or the failure to comply with these laws or regulations could have a material adverse impact on our business. Certain of these laws and regulations pertain specifically to REITs.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our executive and administrative office is located at 1211 Avenue of the Americas New York, New York 10036, telephone 212-696-0100. This office is leased under a non-cancelable lease expiring September 30, 2025.

For a description of the commercial real estate properties we own as part of our investment portfolio, refer to the section titled "Schedule III – Real Estate and Accumulated Depreciation" of Item 15. "Exhibits, Financial Statement Schedules."

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business. At December 31, 2017, we were not party to any pending material legal proceedings.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

PART II
ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock began trading publicly on October 8, 1997 and is traded on the New York Stock Exchange under the trading symbol "NLY." As of January 31, 2018, we had 1,159,623,410 shares of common stock issued and outstanding which were held by approximately 393,000 beneficial holders.

The following table sets forth, for the periods indicated, the high, low, and closing prices per share of our common stock as reported on the New York Stock Exchange composite tape and the cash dividends declared per share of our common stock.

	2017				2016			
	High	Low	Close	Common Dividends Declared Per Share	High	Low	Close	Common Dividends Declared Per Share
First quarter	$11.37	$9.95	$11.11	$ 0.30	$10.48	$8.25	$10.26	$ 0.30
Second quarter	$12.73	$11.09	$12.05	$ 0.30	$11.13	$10.16	$11.07	$ 0.30
Third quarter	$12.58	$11.70	$12.19	$ 0.30	$11.29	$10.33	$10.50	$ 0.30
Fourth quarter	$12.43	$10.97	$11.89	$ 0.30	$10.50	$9.83	$9.97	$ 0.30

On January 31, 2018, the last reported sale price of our common stock on the New York Stock Exchange was $10.54 per share.

Dividends

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments). This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected. In addition, unrealized changes in the estimated fair value of available-for-sale investments may have a direct effect on dividends. All distributions will be made at the discretion of our Board and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board may deem relevant from time to time. See also Item 1A. "Risk Factors." No dividends can be paid on our common stock unless we have paid full cumulative dividends on our preferred stock. From the date of issuance of our preferred stock through December 31, 2017, we have paid full cumulative dividends on our preferred stock.

Share Performance Graphs
The following graphs and tables set forth certain information comparing the yearly percentage change in cumulative total return on our common stock to the cumulative total return of the Standard & Poor's Composite 500 stock Index or S&P 500 Index, and the Bloomberg Mortgage REIT Index, or BBG REIT index, an industry index of mortgage REITs. The comparisons are for the four-, five- and ten-year periods ended December 31, 2017 and assume the reinvestment of dividends. Each graph and table assumes that $100 was invested in our common stock and the two other indices on the last trading day of the initial year shown in the graph. The four-year and ten-year periods are presented in addition to the five-year period required by the SEC because they provide additional perspectives that management believes are of interest to our stockholders. The four-year period provides a view of share performance

that aligns with the tenure of the current investment team, which has been in place since the beginning of 2014, and the ten-year period provides a long-term view of share performance. Upon written request we will provide stockholders with a list of the REITs included in the BBG REIT Index.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

Five-Year Share Performance

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
Annaly Capital Management, Inc.	100	82	98	96	115	151
S&P 500 Index	100	132	150	152	170	206
BBG REIT Index	100	98	117	106	129	154

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters And Issuer Purchases Of Equity Securities

Four-Year Share Performance

	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
Annaly Capital Management, Inc.	100	120	118	140	184
S&P 500 Index	100	114	115	129	156
BBG REIT Index	100	119	108	131	157

Ten-Year Share Performance

	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Annaly Capital Management, Inc.	100	99	124	147	151	152	124	149	146
S&P 500 Index	100	63	80	92	94	109	143	163	165
BBG REIT Index	100	60	75	93	91	109	107	127	115

The information in the share performance graphs and tables has been obtained from sources believed to be reliable, but neither the accuracy nor completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

The above performance graphs and related information shall not be deemed to be “soliciting material” or to be “filed” with the SEC or subject to Regulation 14A or 14C under the

Securities Exchange Act of 1934 (the “Securities Exchange Act”) or to the liabilities of Section 18 of the Securities Exchange Act, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act, except to the extent that we specifically incorporate it by reference into such a filing.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 6. Selected Financial Data

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data should be read in conjunction with the more detailed information contained in the Consolidated Financial Statements and Notes thereto and "Management's

Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K.

SELECTED FINANCIAL DATA

	For the Years Ended December 31,				
Statement of Comprehensive Income Data:	2017	2016	2015	2014	2013
	(dollars in thousands, except per share data)				
Interest income	$2,493,126	$2,210,951	$2,170,697	$2,632,398	$2,918,127
Interest expense	1,008,354	657,752	471,596	512,659	624,714
Net interest income	1,484,772	1,553,199	1,699,101	2,119,739	2,293,413
Realized and unrealized gains (losses)	199,493	84,204	(1,021,351)	(2,791,399)	1,598,445
Other income (loss)	115,857	44,144	(13,717)	44,044	78,134
Less: Total general and administrative expenses	224,124	250,356	200,240	209,338	232,081
Income (loss) before income taxes	1,575,998	1,431,191	463,793	(836,954)	3,737,911
Less: Income taxes	6,982	(1,595)	(1,954)	5,325	8,213
Net income (loss)	1,569,016	1,432,786	465,747	(842,279)	3,729,698
Net income (loss) attributable to noncontrolling interest	(588)	(970)	(809)	(196)	—
Net income (loss) attributable to Annaly	1,569,604	1,433,756	466,556	(842,083)	3,729,698
Dividends on preferred stock	109,635	82,260	71,968	71,968	71,968
Net income (loss) available (related) to common stockholders	$1,459,969	$1,351,496	$394,588	$(914,051)	$3,657,730
Net income (loss) per share available (related) to common stockholders:					
Basic	$1.37	$1.39	$0.42	$(0.96)	$3.86
Diluted	$1.37	$1.39	$0.42	$(0.96)	$3.74
Weighted average number of common shares outstanding:					
Basic	1,065,923,652	969,787,583	947,062,099	947,539,294	947,337,915
Diluted	1,066,351,616	970,102,353	947,276,742	947,539,294	995,557,026
Other Financial Data:					
Total assets	$101,760,050	$87,905,046	$75,190,893	$88,355,367	$81,922,460
Total equity	$14,871,573	$12,575,972	$11,905,922	$13,333,781	$12,405,055
Dividends declared per common share	$1.20	$1.20	$1.20	$1.20	$1.50

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Special Note Regarding Forward-Looking Statements

Certain statements contained in this annual report, and certain statements contained in our future filings with the Securities and Exchange Commission (the “SEC” or the “Commission”), in our press releases or in our other public or stockholder communications contain or incorporate by reference certain forward-looking statements which are based on various assumptions (some of which are beyond our control) and may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as “may,” “will,” “believe,” “expect,” “anticipate,” “continue,” similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, changes in interest rates; changes in the yield curve; changes in prepayment rates; the availability of mortgage-backed securities and other securities for purchase; the availability of financing and, if available, the terms of any financing; changes in the market value of our assets; changes in business conditions and the general economy; our ability to grow our commercial business; our ability to grow our residential mortgage credit business; our ability to grow our middle market lending business; credit risks related to our investments in credit risk transfer securities, residential mortgage-backed securities and related residential mortgage

credit assets, commercial real estate assets and corporate debt; risks related to investments in mortgage servicing rights (“MSRs”); our ability to consummate any contemplated investment opportunities; changes in government regulations or policy affecting our business; our ability to maintain our qualification as a real estate investment trust (“REIT”) for U.S. federal income tax purposes; and our ability to maintain our exemption from registration under the Investment Company Act. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, see “Risk Factors” in this Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q or Current Reports on Form 8-K. We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

All references to “Annaly,” “we,” “us,” or “our” mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. Refer to the section titled “Glossary of Terms” located at the end of this Item 7 for definitions of commonly used terms in this annual report on Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 7. Management's Discussion and Analysis

INDEX TO ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a leading diversified capital manager that invests in and finances residential and commercial assets. Our principal business objective is to generate net income for distribution to our stockholders and to preserve capital through prudent selection of investments, and continuous management of our portfolio. We are a Maryland corporation that has elected to be taxed as a REIT. We are externally managed by Annaly Management Company LLC (“Manager”). Our common stock is listed on the New York Stock Exchange under the symbol “NLY.”

We use our capital coupled with borrowed funds to invest primarily in real estate related investments, earning the spread between the yield on our assets and the cost of our borrowings and hedging activities.

For a full discussion of our business, refer to the section titled “Business Overview” of Part I, Item 1. “Business.”

Business Environment
Stable economic growth, strong business optimism, strong demand for fixed-income products, and low levels of volatility in financial markets supported fixed income returns and allowed us to achieve an attractive economic return on our portfolio in 2017. Most of our portfolio activity included deploying the capital from our common and preferred equity raises. Given that Agency option-adjusted spreads reached some of their most attractive levels since 2013 in early summer 2017, both on a stand-alone basis and relative to credit, much of the capital from the equity raises was deployed into Agency mortgage-backed securities. Because the credit sector in general has reached rather full valuations, we continue, in our disciplined approach, to grow our credit businesses in parts of the sector that remain more attractive, including certain types of residential whole loans or our middle-market lending business. Meanwhile, we continue to avoid investment opportunities where we are uncomfortable with credit fundamentals or credit protection.

Economic Environment

The pace of economic growth accelerated in 2017, remaining above estimated potential growth. Measured by real gross domestic product (“GDP”), activity increased by 2.5% in the fourth quarter of 2017 from prior year, comparing favorably to 1.8% growth in 2016 and the post-crisis average growth of 2.2%. The increased pace was largely due to a pick-up in non-residential investment, expanding by a 6.3% compared to (0.6%) in 2016. While much of this was likely due to the oil price rebound which led to greater mining and manufacturing activity, business sentiment remained elevated amidst expectations of a more stimulative fiscal environment. Consumption remained very strong, increasing by 2.8% in 2017 unchanged from 2016, with lower savings making up for slower income growth. Residential investment slowed, expanding by 2.3% compared to 2.5% in 2016,

constrained by higher mortgage rates and moderate income gains. The trade balance continued to reduce GDP growth, subtracting 0.18% from 2017 growth compared to a (0.23%) drag in 2016. This reduction has occurred despite a 6.0% drop in the trade-weighted US dollar in 2017, according to Federal Reserve Board calculations.

The Fed currently conducts monetary policy with a dual mandate: full employment and price stability. The unemployment rate fell from 4.7% to 4.1% in 2017, which is below the Fed’s estimate of the long-run unemployment rate of 4.6%, according to the Bureau of Labor Statistics. The economy added 171,000 jobs per month in 2017, compared to 187,000 per month in 2016. The hiring rate remained above labor force growth in 2017, and is expected to continue to put downward pressure on the unemployment rate in 2018. Despite the strong labor market and drop in unemployment, wage growth, as measured by the year-over-year change in Average Hourly Earnings, slowed considerably in 2017 at 2.5% year-over-year compared to a 2.9% year-over-year increase in 2016. The increased labor force tightness combined with corporate tax cuts is likely to reverse this trend as wage growth is likely to accelerate in 2018. The Fed sees labor markets continuing to improve in 2018, projecting the unemployment rate to drop to 3.9% as of their December 13, 2017 economic projections.

Inflation was below the Fed's 2% target in 2017, as measured by the year-over-year changes in the Personal Consumer Expenditure Chain Price Index ("PCE"), as inflation weakness appeared broad-based. The headline PCE measure increased by 1.48% year-over-year in 2017, in line with the increase in 2016. The more stable core PCE measure, which excludes volatile food and energy prices, exhibited weakness in 2017, particularly through the summer months, finishing the year at 1.5% year-over-year compared to 1.9% in 2016. Part of the weakness was due to one-time large declines in single components, most notably a 10% drop in cellular telephone prices from February to April. The Fed expects a moderate rise in inflation in both the PCE and core PCE measures to 1.9% year-over-year by the fourth quarter of 2018, before rising to its target of 2.0% in the fourth quarter of 2019 where it is expected to remain in 2020.

Throughout 2017, the Federal Open Market Committee ("FOMC") aimed to support its dual mandate by keeping its target for the federal funds rate at accommodative levels, while taking the historic step in gradually reducing the size of its portfolio of U.S. Treasury and Agency mortgage-backed securities holdings. In assessing realized and expected progress towards its objectives, the FOMC increased the target range for the federal funds rate to 0.75%-1.00% at its March 15, 2017 meeting, to 1.00%-1.25% at the June 14, 2017 meeting, then to 1.25%-1.50% at the December 13, 2017 meeting. Despite unexpected inflation weakness, the drop in unemployment and continued loosening of financial conditions allowed the FOMC to meet its interest rate hike forecast over the year and continue to forecast further hikes in 2018 and 2019. At the September

19-20, 2017 meeting, the FOMC officially announced the initiation of its plan to gradually cease reinvestments in October 2017. The program involves caps on runoff amounts, beginning at $6.0 billion per month for U.S. Treasury securities and $4.0 billion per month for Agency mortgage-backed securities, which will be increased by equal amounts every three months until maximum monthly runoff levels of $30.0 billion and $20.0 billion, respectively, are reached.

During 2017, the 10-year U.S. Treasury Rate was largely range-bound following the substantial post-election sell-off in the fourth quarter of 2016, remaining between 2.04% and 2.63% as markets saw an extremely low-volatility environment with no major risk events. The market’s pricing

of future inflation, as measured by trading in the Treasury Inflation-Protected Securities market, fluctuated throughout the year as inflation missed expectations, rebounding in the second half largely due to a 42% increase in crude oil prices from a June 21, 2017 low to year-end. The mortgage basis, or the spread between the 30-year Agency mortgage-backed security coupon and 10-year U.S. Treasury Rate, declined significantly throughout the year, according to Bloomberg, reflecting strong supply-demand dynamics and a market prepared for the Fed’s balance sheet runoff.

The following table below presents interest rates at each date presented:

	As of December 31,		
	2017	2016	2015
30-Year mortgage current coupon	3.00%	3.13%	3.00%
Mortgage basis	59 bps	68 bps	73 bps
10-Year U.S. Treasury rate	2.41%	2.44%	2.27%
LIBOR:			
1-Month	1.56%	0.77%	0.43%
6-Month	1.84%	1.32%	0.84%

Financial Regulatory Reform

Uncertainty remains surrounding financial regulatory reform and its impact on the markets and the broader economy. It is difficult to predict the ultimate outcomes of legislative and other regulatory efforts. We continue to monitor these developments and to evaluate the potential impact on our businesses.

Income Tax Reform

The recently enacted tax law informally known as the Tax Cuts and Jobs Act (the “TCJA”) significantly changes the U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders. Technical corrections or other amendments to the TCJA or administrative guidance interpreting the TCJA may be forthcoming at any time. We continue to analyze the overall effects of the TCJA to our operations, our industry and the economy in general. While we do not expect to see a material impact on our operations, we anticipate certain of our individual taxable shareholders may benefit by receiving a 20% deduction on the portion of our dividends characterized as ordinary income. We have posted 'Tax Cuts and Jobs Act Treatment of REIT Dividends' on our website (www.annaly.com) in the Investors section under Tax Information. We also advise our shareholders to contact their individual tax advisor to determine how their individual tax profile is affected. In connection with the TCJA, the Company’s discussion of material federal income tax considerations with respect to ownership of our capital stock, is supplemented by, and should be read together with the

information set forth in "Additional Material U.S. Federal Income Tax Considerations," attached hereto as Exhibit 99.1, which is incorporated herein by reference.

Results of Operations

The results of our operations are affected by various factors, many of which are beyond our control. Certain of such risks and uncertainties are described herein (see "Special Note Regarding Forward-Looking Statements" above) and in Part I, Item 1A. "Risk Factors."

This Management Discussion and Analysis section contains analysis and discussion of financial results computed in accordance with U.S. generally accepted accounting principles ("GAAP") and non-GAAP measurements. To supplement our consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide non-GAAP financial measures to enhance investor understanding of our period-over-period operating performance and business trends, as well as for assessing our performance versus that of industry peers.

Please refer to the "Non-GAAP Financial Measures" section for additional information.

Net Income (Loss) Summary

The following table presents financial information related to our results of operations as of and for the years ended December 31, 2017, 2016 and 2015.

	As of and for the Years Ended December 31,		
	2017	2016	2015
	(dollars in thousands, except per share data)		
Interest income	$2,493,126	$2,210,951	$2,170,697
Interest expense	1,008,354	657,752	471,596
Net interest income	1,484,772	1,553,199	1,699,101
Realized and unrealized gains (losses)	199,493	84,204	(1,021,351)
Other income (loss)	115,857	44,144	(13,717)
Less: Total general and administrative expenses	224,124	250,356	200,240
Income (loss) before income taxes	1,575,998	1,431,191	463,793
Less: Income taxes	6,982	(1,595)	(1,954)
Net income (loss)	1,569,016	1,432,786	465,747
Net income (loss) attributable to noncontrolling interest	(588)	(970)	(809)
Net income (loss) attributable to Annaly	1,569,604	1,433,756	466,556
Dividends on preferred stock	109,635	82,260	71,968
Net income (loss) available (related) to common stockholders	$1,459,969	$1,351,496	$394,588
Net income (loss) per share available (related) to common stockholders:			
Basic	$1.37	$1.39	$0.42
Diluted	$1.37	$1.39	$0.42
Weighted average number of common shares outstanding:			
Basic	1,065,923,652	969,787,583	947,062,099
Diluted	1,066,351,616	970,102,353	947,276,742
Other information:			
Asset portfolio at period-end	$99,935,666	$85,364,917	$72,797,193
Average total assets	$91,374,962	$81,033,136	$78,621,261
Average equity	$13,371,907	$12,192,715	$12,648,686

Leverage at period-end [(1)]	5.7:1	5.8:1	5.1:1
Economic leverage at period-end [(2)]	6.6:1	6.4:1	6.0:1
Capital ratio [(3)]	12.9 %	13.1 %	13.7 %
Annualized return (loss) on average total assets	1.72 %	1.77 %	0.59 %
Annualized return (loss) on average equity	11.73 %	11.75 %	3.68 %
Annualized core return on average equity (excluding PAA) [(4)]	10.54 %	9.96 %	10.17 %
Net interest margin [(5)]	1.38 %	1.48 %	1.61 %
Net interest margin (excluding PAA) [(4)]	1.51 %	1.50 %	1.69 %
Average yield on interest earning assets	2.78 %	2.81 %	2.87 %
Average yield on interest earning assets (excluding PAA) [(4)]	2.94 %	2.83 %	2.96 %
Average cost of interest bearing liabilities	1.75 %	1.62 %	1.64 %
Net interest spread	1.03 %	1.19 %	1.23 %
Net interest spread (excluding PAA) [(4)]	1.19 %	1.21 %	1.32 %
Constant prepayment rate [(6)]	10.6 %	13.3 %	10.6 %
Long-term constant prepayment rate [(6)]	10.4 %	10.1 %	8.8 %
Common stock book value per share	$11.34	$11.16	$11.73
Interest income (excluding PAA) [(4)]	$2,634,962	$2,229,892	$2,244,062
Economic interest expense [(4)]	$1,334,093	$1,085,118	$1,041,712
Economic net interest income (excluding PAA) [(4)]	$1,300,869	$1,144,774	$1,202,350
Core earnings [(4)]	$1,267,160	$1,194,884	$1,211,943
Premium amortization adjustment cost (benefit)	$141,836	$18,941	$73,365
Core earnings (excluding PAA) [(4)]	$1,408,996	$1,213,825	$1,285,308
Core earnings per common share [(4)]	$1.09	$1.15	$1.20
PAA cost (benefit) per common share	$0.13	$0.02	$0.08
Core earnings (excluding PAA) per common share [(4)]	$1.22	$1.17	$1.28

(1) Debt consists of repurchase agreements, other secured financing, securitized debt, participation sold and mortgages payable. Securitized debt, participation sold and mortgages payable are non-recourse to us.

(2) Computed as the sum of Recourse Debt, TBA derivative notional outstanding and net forward purchases of investments divided by total equity.

(3) Represents the ratio of stockholders' equity to total assets (inclusive of total market value of TBA derivatives and exclusive of securitized debt of consolidated VIEs).

(4) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

(5) Represents the sum of annualized economic net interest income, inclusive of interest expense on interest rate swaps used to hedge cost of funds, plus TBA dollar roll income less interest expense on interest rate swaps used to hedge TBA dollar roll transactions, divided by the sum of average Interest Earning Assets plus average outstanding TBA contract balances.

(6) In addition to other market factors, the change in 2016 CPR compared to other periods presented also reflects the change in portfolio mix due to the acquisition of Hatteras Financial Corp. in 2016 ("Hatteras" and such acquisition, the "Hatteras Acquisition").

2017 Compared with 2016

GAAP

Net income (loss) was $1.6 billion, which includes ($0.6) million attributable to a noncontrolling interest, or $1.37 per average basic common share, for the year ended December 31, 2017 compared to $1.4 billion, which includes ($1.0) million attributable to a noncontrolling interest, or $1.39 per average basic common share, for the same period in 2016. We attribute the majority of the change in net income (loss) to an increase in unrealized gains on interest rate swaps and lower interest expense on interest rate swaps, partially offset by the change in net unrealized gains (losses) on investments measured at fair value through earnings and lower net interest income during the year ended December 31, 2017 compared to the same period in 2016. Unrealized gains on interest rate swaps were $512.9 million for the year ended December 31, 2017 compared with $282.2 million for the same period in 2016, reflecting a rise in forward interest rates during the year ended December 31, 2017 compared to lower forward rates during the same period in 2016. Interest expense on interest rate swaps decreased $135.6 million to ($371.1) million for the year ended December 31, 2017 reflecting lower net rates during the year ended December 31, 2017 compared to the same period in 2016. Net unrealized gains (losses) on investments measured at fair value through earnings were ($39.7) million for the year ended December 31, 2017 compared to $86.4 million for the same period in 2016, the change was primarily due to unfavorable changes in unrealized gains (losses) on MSRs, partially offset by higher unrealized gains on non-agency mortgage-backed securities and lower unrealized losses on Agency interest-only investments. Net interest income decreased $68.4 million to $1.5 billion for the year ended December 31, 2017, primarily due to higher cost of funds largely attributable to higher rates and higher average balances on repurchase agreements, partially offset by higher coupon income earned from an increase in average Interest Earning Assets for the year ended December 31, 2017 compared to the same period in 2016.

Non-GAAP
Core earnings (excluding premium amortization adjustment (“PAA”)) were $1.4 billion, or $1.22 per average basic common share, for the year ended December 31, 2017, compared to $1.2 billion, or $1.17 per average basic common share, for the same period in 2016. Core earnings increased during the year ended December 31, 2017 compared to the same period in 2016 primarily due to higher coupon income earned resulting from an increase in average Interest Earning Assets and lower interest expense on interest rate swaps, partially offset by an increase in interest expense from higher rates and an increase in average Interest Bearing Liabilities.

2016 Compared with 2015

GAAP
Net income (loss) was $1.4 billion, which includes ($1.0) million attributable to a noncontrolling interest, or $1.39 per average basic common share, for the year ended December 31, 2016 compared to $465.7 million, which includes ($0.8) million attributable to a noncontrolling interest, or $0.42 per average basic common share, for the same period in 2015. We attribute the majority of the change in net income (loss) to favorable changes in realized and unrealized gains (losses), change in net gains (losses) on trading assets, and unrealized gains on investments measured at fair value partially offset by lower net interest income. Net realized and unrealized losses on interest rate swaps was ($338.4) million for the year ended December 31, 2016 compared to ($975.8) million for the same period in 2015. Unrealized gains (losses) on interest rate swaps was $282.2 million for the year ended December 31, 2016 compared to ($124.9) million for the same period in 2015, reflecting a rise in forward interest rates during the year ended December 31, 2016 compared to lower forward rates during the same period in 2015. Interest expense on interest rate swaps decreased $117.8 million to ($506.7) million for the year ended December 31, 2016 reflecting lower swap positions and lower net rates during the year ended December 31, 2016 compared to the same period in 2015. Realized losses on termination of interest rate swaps decreased $112.5 million to ($113.9) million for the year ended December 31, 2016 compared to the same period in 2015. Net gains (losses) on trading assets was $230.6 million for the year ended December 31, 2016, which includes net gains on futures contracts of $112.5 million, compared with $29.6 million for the same period in 2015, which includes a net loss on futures contracts of ($64.1) million. Net interest income decreased $145.9 million, primarily due to higher cost of funds largely attributable to higher rates on repurchase agreements for the year ended December 31, 2016 compared to the same period in 2015.

Non-GAAP
Core earnings (excluding PAA) were $1.2 billion, or $1.17 per average basic common share, for the year ended December 31, 2016, compared to $1.3 billion, or $1.28 per average basic common share, for the same period in 2015. Core earnings decreased during the year ended December 31, 2016 compared to the same period in 2015 primarily due to higher interest expense on higher Interest Bearing Liabilities, partially offset by a decrease in interest expense on interest rate swaps.

Non-GAAP Financial Measures

To supplement our consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide the following non-GAAP financial measures.

- core earnings and core earnings (excluding PAA);
- core earnings and core earnings (excluding PAA) per average common share;
- annualized core return on average equity (excluding PAA);
- interest income (excluding PAA);
- economic interest expense;

- economic net interest income (excluding PAA);
- average yield on Interest Earning Assets (excluding PAA);
- net interest margin (excluding PAA); and
- net interest spread (excluding PAA).

These measures should not be considered a substitute for, or superior to, financial measures computed in accordance with GAAP. While intended to offer a fuller understanding of our results and operations, non-GAAP financial measures also have limitations. For example, we may calculate our non-GAAP metrics, such as core earnings, or the PAA, differently than our peers making comparative analysis difficult. Additionally, in the case of non-GAAP measures that exclude the PAA, the amount of amortization expense excluding the PAA is not necessarily representative of the amount of future periodic amortization nor is it indicative of the term over which we will amortize the remaining unamortized premium. Changes to actual and estimated prepayments will impact the timing and amount of premium amortization and, as such, both GAAP and non-GAAP results.

These non-GAAP measures provide additional detail to enhance investor understanding of our period-over-period operating performance and business trends, as well as for assessing our performance versus that of industry peers. Additional information pertaining to the our use of these non-GAAP financial measures, including discussion of how each such measure is useful to investors, and reconciliations to their most directly comparable GAAP results are provided below.

Amortization

In accordance with GAAP, we amortize or accrete premiums or discounts into interest income for our Agency mortgage-backed securities, excluding interest-only securities, taking into account estimates of future principal prepayments in the calculation of the effective yield. We recalculate the effective yield as differences between anticipated and actual prepayments occur. Using third-party model and market information to project future cash flows and expected remaining lives of securities, the effective interest rate determined for each security is applied as if it had been in place from the date of the security's acquisition. The amortized cost of the security is then adjusted to the amount that would have existed had the new effective yield been applied since the acquisition date. The adjustment to amortized cost is offset with a charge or credit to interest income. Changes in interest rates and other market factors will impact prepayment speed projections and the amount of premium amortization recognized in any given period.

Our GAAP metrics include the unadjusted impact of amortization and accretion associated with this method. Certain of the our non-GAAP metrics exclude the effect of the PAA, which quantifies the component of premium amortization representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term CPR.

The following table illustrates the impact of the PAA on premium amortization expense for our Residential Investment Securities portfolio for the periods presented:

	For the Years Ended December 31,		
	2017	2016	2015
	(dollars in thousands)		
Premium amortization expense	$879,305	$814,575	$793,657
Less: PAA Cost (Benefit)	141,836	18,941	73,365
Premium amortization expense exclusive of PAA	$737,469	$795,634	$720,292

	For the Years Ended December 31,		
	2017	2016	2015
	(per average common share)		
Premium amortization expense	$0.82	$0.84	$0.84
Less: PAA Cost (Benefit)	0.13	0.02	0.08
Premium amortization expense exclusive of PAA	$0.69	$0.82	$0.76

Core earnings and core earnings (excluding PAA), core earnings and core earnings (excluding PAA) per average common share and annualized core return on average equity (excluding PAA)

One of our principal business objectives is to generate net income by earning a net interest spread on our investment portfolio, which is a function of our interest income from our investment portfolio less financing, hedging and operating costs. Core earnings, which is comprised of interest income

plus TBA dollar roll income, less financing and hedging costs and general and administrative expenses, and core earnings (excluding PAA), are used by management and, we believe, used by our analysts and investors, to measure its progress in achieving this objective.

We define “core earnings”, a non-GAAP measure, as net income (loss) excluding gains or losses on disposals of investments and termination of interest rate swaps, unrealized gains or losses on interest rate swaps and investments measured at fair value through earnings, net gains and losses on trading assets, impairment losses, net income (loss) attributable to noncontrolling interest, corporate acquisition related expenses and certain other non-recurring gains or losses, and inclusive of TBA dollar roll income (a component of Net gains (losses) on trading assets) and realized amortization of MSRs (a component of net unrealized gains (losses) on investments measured at fair value through earnings). Core earnings (excluding PAA) excludes the premium amortization adjustment representing the cumulative impact on prior periods, but not the current period, of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities.

We believe these non-GAAP measures provide management and investors with additional details regarding our

underlying operating results and investment portfolio trends by (i) making adjustments to account for the disparate reporting of changes in fair value where certain instruments are reflected in GAAP net income (loss) while others are reflected in other comprehensive income (loss), and (ii) by excluding certain unrealized, non-cash or episodic components of GAAP net income (loss) in order to provide additional transparency into the operating performance of our portfolio. Annualized core return on average equity (excluding PAA), which is calculated by dividing core earnings (excluding PAA) over average stockholders' equity, provides investors with additional detail on the core earnings generated by our invested equity capital.

The following table presents a reconciliation of GAAP financial results to non-GAAP core earnings for the periods presented:

	For the Years Ended December 31,		
	2017	2016	2015
	(dollars in thousands, except per share data)		
GAAP net income (loss)	$1,569,016	$1,432,786	$465,747
Less:			
Realized (gains) losses on termination of interest rate swaps	160,133	113,941	226,462
Unrealized (gains) losses on interest rate swaps	(512,918)	(282,190)	124,869
Net (gains) losses on disposal of investments	3,938	(33,089)	(50,987)
Net (gains) losses on trading assets	(261,438)	(230,580)	(29,623)
Net unrealized (gains) losses on financial instruments measured at fair value through earnings	39,684	(86,391)	103,169
Bargain purchase gain	—	(72,576)	—
Impairment of goodwill	—	—	22,966
Corporate acquisition related expenses (1)	—	48,887	—
Net (income) loss attributable to noncontrolling interest	588	970	809
Plus:			
TBA dollar roll income (loss) (2)	334,824	351,778	348,531
MSR amortization (3)	(66,667)	(48,652)	—
Core earnings (4)	1,267,160	1,194,884	1,211,943
Less:			
Premium amortization adjustment cost (benefit)	141,836	18,941	73,365
Core earnings (excluding PAA) (4)	$1,408,996	$1,213,825	$1,285,308
GAAP net income (loss) per common share	$1.37	$1.39	$0.42
Core earnings per common share (4)	$1.09	$1.15	$1.20
Core earnings (excluding PAA) per common share (4)	$1.22	$1.17	$1.28
Annualized GAAP return (loss) on average equity	11.73%	11.75%	3.68%

Annualized core return on average equity (excluding PAA) [4]	10.54 %	9.96 %	10.17 %

(1) Represents transaction costs incurred in connection with the Hatteras Acquisition.

(2) Represents a component of Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

(3) Represents the portion of changes in fair value that is attributable to the realization of estimated cash flows on our MSR portfolio and is reported as a component of Net unrealized (gains) losses on investments measured at fair value through earnings in the Consolidated Statements of Comprehensive Income (Loss).

(4) Represents a non-GAAP financial measure. Refer to the "Non-GAAP Financial Measures" section for additional information.

From time to time, we enter into TBA forward contracts as an alternate means of investing in and financing Agency mortgage-backed securities. A TBA contract is an agreement to purchase or sell, for future delivery, an Agency mortgage-backed security with a specified issuer, term and coupon. A

TBA dollar roll represents a transaction where TBA contracts with the same terms but different settlement dates are simultaneously bought and sold. The TBA contract settling in the later month typically prices at a discount to the earlier month contract with the difference in price commonly referred to as the “drop”. The drop is a reflection of the expected net interest income from an investment in similar Agency mortgage-backed securities, net of an implied financing cost, that would be foregone as a result of settling the contract in the later month rather than in the earlier month. The drop between the current settlement month price and the forward settlement month price occurs because in the TBA dollar roll market, the party providing the financing is the party that would retain all principal and interest payments accrued during the financing period. Accordingly, TBA dollar roll income generally represents the economic equivalent of the net interest income earned on the underlying Agency mortgage-backed security less an implied financing cost.

TBA dollar roll transactions are accounted for under GAAP as a series of derivatives transactions. The fair value of TBA derivatives is based on methods similar to those used to value Agency mortgage-backed securities. We record TBA derivatives at fair value on our Consolidated Statements of Financial Condition and recognize periodic changes in fair value as Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss), which includes both unrealized and realized gains and losses on derivatives (excluding interest rate swaps).

TBA dollar roll income is calculated as the difference in price between two TBA contracts with the same terms but different settlement dates multiplied by the notional amount of the TBA contract. Although accounted for as derivatives, TBA dollar rolls capture the economic equivalent of net interest income, or carry, on the underlying Agency mortgage-backed security (interest income less an implied cost of financing). TBA dollar roll income is reported as a component of Net gains (losses) on trading assets in the Consolidated Statements of Comprehensive Income (Loss).

Interest income (excluding PAA), economic interest expense and economic net interest income (excluding PAA)

Interest income (excluding PAA) represents interest income excluding the effect of the premium amortization adjustment, and serves as the basis for deriving average yield on Interest Earning Assets (excluding PAA), net interest spread (excluding PAA) and net interest margin (excluding PAA), which are discussed below. We believe this measure provides management and investors with additional detail to enhance their understanding of our operating results and trends by excluding the component of premium amortization expense representing the cumulative effect of quarter-over-quarter changes in estimated long-term prepayment speeds related to our Agency mortgage-backed securities (other than interest-only securities), which can obscure underlying trends in the performance of the portfolio.

Economic interest expense is comprised of interest expense, as computed in accordance with GAAP, plus interest expense on interest rate swaps used to hedge the cost of funds, which is a component of Realized gains (losses) on interest rate swaps in the Consolidated Statements of Comprehensive Income (Loss). We use interest rate swaps to manage our exposure to changing interest rates on repurchase agreements by economically hedging cash flows associated with these borrowings. Accordingly, adding the contractual interest payments on interest rate swaps to interest expense, as computed in accordance with GAAP, reflects the total contractual interest expense and thus, provides investors with additional information about the cost of our financing strategy.

Similarly, economic net interest income (excluding PAA), as computed below, provides investors with additional information to enhance their understanding of the net economics of our primary business operations.

The following tables provide GAAP measures of interest expense and net interest income and details with respect to reconciling the aforementioned line items on a non-GAAP basis for each respective period:

Interest Income (excluding PAA)

	GAAP Interest Income	PAA Cost (Benefit)	Interest Income (excluding PAA)
For the Years Ended:	(dollars in thousands)		
December 31, 2017	$2,493,126	$141,836	$2,634,962
December 31, 2016	$2,210,951	$18,941	$2,229,892
December 31, 2015	$2,170,697	$73,365	$2,244,062

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
Item 7. Management’s Discussion and Analysis

Economic Interest Expense and Economic Net Interest Income (excluding PAA)

	GAAP Interest Expense	Add: Interest Expense on Interest Rate Swaps Used to Hedge Cost of Funds [1]	Economic Interest Expense	GAAP Net Interest Income	Less: Interest Expense on Interest Rate Swaps Used to Hedge Cost of Funds [1]	Economic Net Interest Income	Add: PAA Cost (Benefit)	Economic Net Interest Income (excluding PAA)
For the Years Ended:	(dollars in thousands)							
December 31, 2017	$1,008,354	$325,739	$1,334,093	$1,484,772	$325,739	$1,159,033	$141,836	$1,300,869
December 31, 2016	$657,752	$427,366	$1,085,118	$1,553,199	$427,366	$1,125,833	$18,941	$1,144,774
December 31, 2015	$471,596	$570,116	$1,041,712	$1,699,101	$570,116	$1,128,985	$73,365	$1,202,350

(1) A component of realized gains (losses) on interest rate swaps on the Consolidated Statements of Comprehensive Income (Loss).

Experienced and Projected Long-term CPR

Prepayment speeds, as reflected by the Constant Prepayment Rate (“CPR”) and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds and expectations of prepayment speeds on our Agency mortgage-backed

securities portfolio increase, related purchase premium amortization increases, thereby reducing the yield on such assets. The following table presents the weighted average experienced CPR and weighted average projected long-term CPR on our Agency mortgage-backed securities portfolio as of or for the periods presented.

	Experienced CPR [1]	Long-term CPR [2]
December 31, 2017	10.6%	10.4%
December 31, 2016	13.3%	10.1%
December 31, 2015	10.6%	8.8%

(1) For the years ended December 31, 2017, 2016 and 2015, respectively.
(2) At December 31, 2017, 2016 and 2015, respectively.

Average Yield on Interest Earning Assets (excluding PAA), Net Interest Spread (excluding PAA) and Net Interest Margin (excluding PAA)

Net interest spread (excluding PAA), which is the difference between the average yield on interest earning assets (excluding PAA) and the average cost of interest bearing liabilities, and net interest margin (excluding PAA), which is calculated as the sum of the annualized economic net interest income (inclusive of interest expense on interest rate swaps used to hedge cost of funds) plus TBA dollar roll income (less

interest expense on swaps used to hedge TBA dollar roll transactions) divided by the sum of its average interest earning assets plus average outstanding TBA derivative balances, provide management with additional measures of our profitability that management relies upon in monitoring the performance of the business.

Disclosure of these measures, which are presented below, provides investors with additional detail regarding how management evaluates our performance.

Economic Net Interest Income (excluding PAA)

	Average Interest Earning Assets (1)	Interest Income (excluding PAA) (2)	Average Yield on Interest Earning Assets (excluding PAA) (2)	Average Interest Bearing Liabilities	Economic Interest Expense (2)(3)	Average Cost of Interest Bearing Liabilities	Economic Net Interest Income (excluding PAA) (2)(3)	Net Interest Spread (excluding PAA) (2)	Net Interest Margin (excluding PAA) (2)(4)
For the Years Ended:	(dollars in thousands)								
December 31, 2017	$89,648,025	$2,634,962	2.94%	$76,321,069	$1,334,093	1.75%	$1,300,869	1.19%	1.51%
December 31, 2016	$78,813,547	$2,229,892	2.83%	$66,817,870	$1,085,118	1.62%	$1,144,774	1.21%	1.50%
December 31, 2015	$75,741,458	$2,244,062	2.96%	$63,535,915	$1,041,712	1.64%	$1,202,350	1.32%	1.69%

(1) Does not reflect the unrealized gains/(losses).

(2) Represents a non-GAAP financial measure. Refer to the “Non-GAAP Financial Measures” section for additional information.

(3) Net of interest expense of interest rate swaps used to hedge cost of funds.

(4) Represents the sum of annualized economic net interest income (excluding PAA), inclusive of interest expense on interest rate swaps used to hedge cost of funds, plus TBA dollar roll income less interest expense on interest rate swaps used to hedge dollar roll transactions divided by the sum of average Interest Earning Assets plus average outstanding TBA contract balances.

Economic Interest Expense and Average Cost of Interest Bearing Liabilities

Typically, our largest expense is the cost of Interest Bearing Liabilities and interest expense on interest rate swaps, which is recorded in realized gains (losses) on interest rate swaps

on the Consolidated Statements of Comprehensive Income (Loss). The table below shows our average Interest Bearing Liabilities and average cost of Interest Bearing Liabilities as compared to average one-month and average six-month LIBOR for the periods presented.

Cost of Funds on Average Interest Bearing Liabilities

	Average Interest Bearing Liabilities	Interest Bearing Liabilities at Period End	Economic Interest Expense [1]	Average Cost of Interest Bearing Liabilities	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average One-Month LIBOR	Average Cost of Interest Bearing Liabilities Relative to Average Six-Month LIBOR
For the Years Ended:	(dollars in thousands)								
December 31, 2017	$76,321,069	$84,505,642	$1,334,093	1.75 %	1.11 %	1.48 %	(0.37 %)	0.64 %	0.27 %
December 31, 2016	$66,817,870	$72,769,189	$1,085,118	1.62 %	0.50 %	1.06 %	(0.56 %)	1.12 %	0.56 %
December 31, 2015	$63,535,915	$60,629,905	$1,041,712	1.64 %	0.20 %	0.49 %	(0.29 %)	1.44 %	1.15 %

(1) Economic interest expense includes interest expense on interest rate swaps used to hedge cost of funds.

2017 Compared with 2016

Economic interest expense, including interest expense on interest rate swaps, increased by $249.0 million for the year ended December 31, 2017 compared to the same period in 2016. The change was primarily due to a $9.5 billion increase in average Interest Bearing Liabilities and higher cost of funds partially offset by lower interest expense on interest rate swaps used to hedge cost of funds for the year ended December 31, 2017 compared to the same period in 2016.

2016 Compared with 2015

Economic interest expense, including interest expense on interest rate swaps, increased by $43.4 million for the year ended December 31, 2016 compared to the same period in 2015. The change was primarily due to the $3.3 billion increase in average Interest Bearing Liabilities offset by lower interest expense on interest rate swaps used to hedge cost of funds for the year ended December 31, 2016 compared to the same period in 2015.

We do not manage our portfolio to have a pre-designated amount of borrowings at quarter or year end. Our borrowings at period end are a snapshot of our borrowings as of a date, and this number may differ from average borrowings over the period for a number of reasons. The mortgage-backed securities we own pay principal and interest towards the end of each month and the mortgage-backed securities we purchase are typically settled during the beginning of the month. As a result, depending on the amount of mortgage-

backed securities we have committed to purchase, we may retain the principal and interest we receive in the prior month, or we may use it to pay down our borrowings. Moreover, we generally use interest rate swaps, swaptions and other derivative instruments to hedge our portfolio, and as we pledge or receive collateral under these agreements, our borrowings on any given day may be increased or decreased. Our average borrowings during a quarter may differ from period end borrowings as we implement our portfolio management strategies and risk management strategies over changing market conditions by increasing or decreasing leverage. Additionally, these numbers may differ during periods when we conduct equity capital raises, as in certain instances we may purchase additional assets and increase leverage with the expectation of a successful equity capital raise. Since our average borrowings and period end borrowings can be expected to differ, we believe our average borrowings during a period provide a more accurate representation of our exposure to the risks associated with leverage than our period end borrowings.

At December 31, 2017 and 2016, the majority of our debt represented repurchase agreements and other secured financing arrangements collateralized by a pledge of our Residential Investment Securities, residential mortgage loans, commercial real estate investments and corporate loans. All of our Residential Investment Securities are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and increase the liquidity and strength of our balance sheet.

Realized and Unrealized Gains (Losses)

Realized and unrealized gains (losses) is comprised of net gains (losses) on interest rate swaps, net gains (losses) on disposal of investments, net gains (losses) on trading assets

and net unrealized gains (losses) on investments measured at fair value through earnings. These components of realized and unrealized gains (losses) for the years ended December 31, 2017, 2016 and 2015 were as follows:

	For the Years Ended December 31,		
	2017	2016	2015
	(dollars in thousands)		
Net gains (losses) on interest rate swaps [1]	$(18,323)	$(338,432)	$(975,826)
Net gains (losses) on disposal of investments	(3,938)	33,089	50,987
Net gains (losses) on trading assets	261,438	230,580	29,623
Net unrealized gains (losses) on investments measured at fair value through earnings	(39,684)	86,391	(103,169)
Bargain purchase gain	—	72,576	—
Impairment of goodwill	—	—	(22,966)
Total	$199,493	$84,204	$(1,021,351)

(1) Includes realized gains (losses) on interest rate swaps, realized gains (losses) on termination of interest rate swaps and unrealized gains (losses) on interest rate swaps.

2017 Compared with 2016

Net losses on interest rate swaps decreased by $320.1 million for the year ended December 31, 2017 compared to the same period in 2016. Unrealized gains on interest rate swaps increased $230.7 million, interest expense on interest rate swaps decreased $135.6 million and realized losses on termination of interest rate swaps increased $46.2 million for the year ended December 31, 2017 compared to the same period in 2016.

For the year ended December 31, 2017, we disposed of Residential Investment Securities with a carrying value of $12.9 billion for an aggregate net loss of $6.4 million. We may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

Net gains (losses) on trading assets was $261.4 million for the year ended December 31, 2017 compared to $230.6 million for the same period in 2016. The change was primarily attributable to higher net gains on TBA contracts, partially offset by an unfavorable change in net gains (losses) on interest rate swaptions recognized for the year ended December 31, 2017 compared to the same period in 2016.

Net unrealized gains (losses) on investments measured at fair value through earnings was ($39.7) million for the year ended December 31, 2017 compared to $86.4 million for the same period in 2016. The change was primarily attributable to unfavorable changes in unrealized gains (losses) on MSRs, partially offset by higher unrealized gains on non-agency mortgage-backed securities and lower unrealized losses on Agency interest-only investments for the year ended December 31, 2017 compared to the same period in 2016.

2016 Compared with 2015

Net losses on interest rate swaps decreased by $637.4 million for the year ended December 31, 2016 compared to the same period in 2015. Unrealized (gains) losses on interest rate swaps was $282.2 million for the year ended December 31, 2016 compared with ($124.9) million for the same period in 2015, realized losses on termination of interest rate swaps decreased $112.5 million, and interest expense on interest rate swaps decreased $117.8 million for the year ended December 31, 2016 compared to the same period in 2015.

For the year ended December 31, 2016, we disposed of Residential Investment Securities with a carrying value of $12.3 billion for an aggregate net gain of $31.0 million. We may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

Net gains (losses) on trading assets was $230.6 million for the year ended December 31, 2016 compared to $29.6 million for the same period in 2015. The change was primarily attributable to a net gain of $112.5 million on futures contracts recognized for the year ended December 31, 2016 compared to a net loss of ($64.1) million on futures contracts recognized for the same period in 2015.

Net unrealized gains (losses) on investments measured at fair value through earnings was $86.4 million for the year ended December 31, 2016 compared to ($103.2) million for the same period in 2015. The change was primarily attributable to unrealized gains on MSRs for the year ended December 31, 2016. The Company did not invest in MSRs during the year ended December 31, 2015.

Other Income (Loss)

Other income (loss) includes certain revenues and costs associated with our investments in commercial real estate, including rental income and recoveries, net servicing income on MSRs, operating and transaction costs as well as depreciation and amortization expense. We report in Other income (loss) items whose amounts, either individually or in the aggregate, would not, in the opinion of management, be meaningful to readers of the financial statements. Given the

nature of certain components of this line item, balances may fluctuate from period to period.

General and Administrative Expenses

General and administrative (“G&A”) expenses consist of compensation expense, the management fee and other expenses. The following table shows our total G&A expenses as compared to average total assets and average equity for the periods presented.

G&A Expenses and Operating Expense Ratios

	Total G&A Expenses (1)	Total G&A Expenses/Average Assets		Total G&A Expenses/Average Equity	
For the Years Ended:	(dollars in thousands)				
December 31, 2017	$224,124	0.25	%	1.68	%
December 31, 2016	$250,356	0.31	%	2.05	%
December 31, 2015	$200,240	0.25	%	1.58	%

(1) Includes $48.9 million in Hatteras Acquisition related expenses for the year ended December 31, 2016.

2017 Compared with 2016

G&A expenses decreased $26.2 million to $224.1 million for the year ended December 31, 2017 compared to the same period in 2016. The change in the period was primarily due to the transaction costs recognized in connection with the Hatteras Acquisition of $48.9 million in 2016, partially offset by higher compensation and management fees reflecting an increase in adjusted stockholders’ equity primarily due to the equity capital raises conducted during the year ended December 31, 2017.

2016 Compared with 2015

G&A expenses increased $50.1 million to $250.4 million for the year ended December 31, 2016 compared to the same period in 2015. The change in the period was primarily due to the transaction costs recognized in connection with the Hatteras Acquisition of $48.9 million for the year ended December 31, 2016.

Unrealized Gains and Losses

With our available-for-sale accounting treatment on our Agency mortgage-backed securities which, represent the largest portion of assets on balance sheet, as well as certain commercial mortgage-backed securities, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders’ equity under accumulated other comprehensive income (loss). As a result of this fair value accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used amortized cost accounting. As a result, comparisons with companies that use amortized cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows cumulative unrealized gains and losses on our available-for-sale investments reflected in the Consolidated Statements of Financial Condition.

	December 31, 2017	December 31, 2016
	(dollars in thousands)	
Unrealized gain	$157,818	$275,680
Unrealized loss	(1,283,838)	(1,361,573)
Net unrealized gain (loss)	$(1,126,020)	$(1,085,893)

Unrealized changes in the estimated fair value of available-for-sale investments may have a direct effect on our potential earnings and dividends: positive changes will increase our equity base and allow us to increase our borrowing capacity while negative changes tend to reduce borrowing capacity. A very large negative change in the net fair value of our available-for-sale Residential Investment Securities might

impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

The fair value of these securities being less than amortized cost for the year ended December 31, 2017 is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered to be other-than-temporarily impaired because we currently have the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments, and it is not more likely than not that we will be required to sell the investments before recovery of the amortized cost bases, which may be maturity. Also, we are guaranteed payment of the principal and interest amounts of the securities by the respective issuing Agency.

Return on Average Equity

Our annualized return (loss) on average equity was 11.73%, 11.75% and 3.68% for the years ended December 31, 2017, 2016 and 2015, respectively.

The table below shows the components of our annualized return on average equity for the periods presented.

Components of Annualized Return on Average Equity

	Economic Net Interest Income/ Average Equity (1)	Realized and Unrealized Gains and Losses/Average Equity (2)	Other Income (Loss)/Average Equity (3)	G&A Expenses/ Average Equity	Income Taxes/ Average Equity	Return on Average Equity
For the Years Ended:						
December 31, 2017	8.67 %	3.93 %	0.86 %	(1.68 %)	(0.05 %)	11.73 %
December 31, 2016	9.23 %	4.20 %	0.36 %	(2.05 %)	0.01 %	11.75 %
December 31, 2015	8.92 %	(3.57 %)	(0.11 %)	(1.58 %)	0.02 %	3.68 %

(1) Economic net interest income includes interest expense on interest rate swaps used to hedge cost of funds.
(2) Realized and unrealized gains and losses excludes interest expense on interest rate swaps used to hedge cost of funds.
(3) Other income (loss) includes investment advisory income, dividend income from affiliate, and other income (loss).

Financial Condition

Total assets were $101.8 billion and $87.9 billion at December 31, 2017 and 2016, respectively. The change was primarily due to increases in Residential Investment Securities and residential mortgage loans of $14.6 billion

and $1.1 billion, respectively, partially offset by a $1.3 billion decrease in commercial real estate investments.

Our portfolio composition, net equity allocation and debt-to-net equity ratio by asset class was as follows at December 31, 2017:

	Residential				Commercial			
	Agency MBS and MSRs	TBAs (1)	CRTs	Non-Agency MBS and Residential Mortgage Loans	CRE Debt & Preferred Equity Investments	Investments in CRE	Corporate Debt	Total (2)

	(dollars in thousands)							
Assets:								
Fair Value/Carrying Value	$91,132,623	$16,134,313	$651,764	$2,535,616	$4,118,435	$485,953	$1,011,275	$99,935
Debt:								
Repurchase agreements	76,703,981	15,578,000	277,971	304,778	409,613	—	—	77,696,
Other secured financing	2,742,510	—	—	679,238	177,074	—	238,706	3,837,5
Securitized debt	—	—	—	350,819	2,620,952	—	—	2,971,7
Mortgages payable	—	—	—	—	—	309,686	—	309,686
Net forward purchases	655,349	—	—	—	—	—	—	655,349
Net Equity Allocated	$11,030,783	$556,313	$373,793	$1,200,781	$910,796	$176,267	$772,569	$14,464
Net Equity Allocated (%)	76 %	4 %	3 %	8 %	7 %	1 %	5 %	100
Debt/Net Equity Ratio	7.3:1	28.0:1	0.7:1	1.1:1	3.5:1	1.8:1	0.3:1	5.7:1

(1) Fair value/carrying value represents implied market value and repurchase agreements represent the notional value.
(2) Excludes the TBA asset, debt and equity balances.
(3) Net Equity Allocated, as disclosed in the above table, excludes non-portfolio related activity and may differ from stockholders' equity per the Consolidated Statements of Financial Condition.
(4) Represents the debt/net equity ratio as determined using amounts on the Consolidated Statements of Financial Condition.

Residential Investment Securities

Substantially all of our Agency mortgage-backed securities at December 31, 2017 and December 31, 2016 were backed by single-family residential mortgage loans and were secured with a first lien position on the underlying single-family properties. Our mortgage-backed securities were largely Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating. We carry all of our Agency mortgage-backed securities at fair value on the Consolidated Statements of Financial Condition.

We accrete discount balances as an increase to interest income over the expected life of the related Interest Earning Assets and we amortize premium balances as a decrease to interest income over the expected life of the related Interest Earning Assets. At December 31, 2017 and December 31, 2016 we had on our Consolidated Statements of Financial Condition a total of $148.3 million and $171.9 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current amortized cost of our Residential Investment Securities acquired at a price below principal value) and a total of $6.2 billion and $5.5 billion, respectively, of unamortized premium (which is the difference between the remaining principal value and the current amortized cost of our Residential Investment Securities acquired at a price above principal value).

The weighted average experienced prepayment speed on our Agency mortgage-backed securities portfolio for the years ended December 31, 2017 and 2016 was 10.6% and 13.3%, respectively. The weighted average projected long-term prepayment speed on our Agency mortgage-backed securities portfolio as of December 31, 2017 and 2016 was 10.4% and 10.1%, respectively.

Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The following table summarizes certain characteristics of our Residential Investment Securities (excluding interest-only mortgage-backed securities) and interest-only mortgage-backed securities at the dates presented.

	December 31, 2017		December 31, 2016	
	(dollars in thousands)			
Residential Investment Securities: (1)				
Principal Amount	$87,518,155		$73,621,439	
Net Premium	4,682,299		3,867,055	
Amortized Cost	92,200,454		77,488,494	
Amortized Cost/Principal Amount	105.35	%	105.25	%
Carrying Value	91,197,901		76,458,517	
Carrying Value / Principal Amount	104.20	%	103.85	%
Weighted Average Coupon Rate	3.69	%	3.54	%
Weighted Average Yield	2.79	%	2.69	%
Adjustable-Rate Residential Investment Securities: (1)				
Principal Amount	$8,002,252		$12,179,455	
Weighted Average Coupon Rate	3.05	%	2.84	%
Weighted Average Yield	2.52	%	2.30	%
Weighted Average Term to Next Adjustment	24 Months		31 Months	
Weighted Average Lifetime Cap (2)	8.12	%	8.09	%
Principal Amount at Period End as % of Total Residential Investment Securities	9.14	%	16.54	%
Fixed-Rate Residential Investment Securities: (1)				
Principal Amount	$79,515,903		$61,441,984	
Weighted Average Coupon Rate	3.75	%	3.68	%
Weighted Average Yield	2.82	%	2.76	%
Principal Amount at Period End as % of Total Residential Investment Securities	90.86	%	83.46	%
Interest-Only Residential Investment Securities:				
Notional Amount	$7,793,767		$8,997,175	
Net Premium	1,342,048		1,451,321	
Amortized Cost	1,342,048		1,451,321	
Amortized Cost/Notional Amount	17.22	%	16.13	%
Carrying Value	1,102,920		1,257,385	
Carrying Value/Notional Amount	14.15	%	13.98	%
Weighted Average Coupon Rate	3.61	%	3.82	%
Weighted Average Yield	4.17	%	5.40	%

(1) Excludes interest-only mortgage-backed securities.

(2) Excludes non-Agency mortgage-backed securities and CRT securities as this attribute is not applicable to these asset classes.

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The following tables summarize certain characteristics of our Residential Credit portfolio at December 31, 2017.

		Payment Structure		Investment Characteristics			
Product	Total	Senior	Subordinate	Coupon	Credit Enhancement	60+ Delinquencies	3M VPR (1)
(dollars in thousands)							
Agency Credit Risk Transfer	$616,886	$—	$616,886	5.29%	1.23%	0.28%	10.36%
Private Label Credit Risk Transfer	34,878	—	34,878	7.43%	5.77%	2.66%	8.01%
Alt-A	183,886	114,456	69,430	4.42%	10.07%	11.15%	9.94%
Prime	192,760	27,056	165,704	4.70%	1.20%	10.47%	14.73%
Subprime	533,880	245,006	288,874	2.52%	14.68%	20.57%	5.92%
Re-Performing Loan Securitizations	33,264	33,264	—	4.09%	42.36%	33.77%	5.72%
Non-Performing Loan Securitizations	9,724	6,290	3,434	4.65%	63.13%	72.25%	3.14%
Prime Jumbo (>=2010 Vintage)	126,622	101,374	25,248	3.59%	14.30%	0.08%	15.62%
Prime Jumbo (>=2010 Vintage) Interest-Only	17,158	17,158	—	0.46%	—	0.04%	14.39%
Total/Weighted Average	$1,749,058	$544,604	$1,204,454	2.78%	5.60%	6.59%	11.35%

(1) Represents the 3 month voluntary prepayment rate ("VPR").

Market Value By Sector and Bond Coupon					
Product	ARM	Fixed	Floater	Interest-Only	Total
(dollars in thousands)					
Agency Credit Risk Transfer	$—	$—	$616,886	$ —	$616,886
Private Label Credit Risk Transfer	—	—	34,878	—	34,878
Alt-A	51,314	106,594	25,978	—	183,886
Prime	90,679	102,081	—	—	192,760
Subprime	—	94,898	438,982	—	533,880
Re-Performing Loan Securitizations	—	33,264	—	—	33,264
Non-Performing Loan Securitizations	—	9,724	—	—	9,724
Prime Jumbo (>=2010 Vintage)	—	126,622	—	—	126,622
Prime Jumbo (>=2010 Vintage) Interest-Only	—	—	—	17,158	17,158
Total	$141,993	$473,183	$1,116,724	$ 17,158	$1,749,058

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Contractual Obligations

The following table summarizes the effect on our liquidity and cash flows from contractual obligations at December 31, 2017. The table does not include the effect of net interest rate payments on our interest rate swap agreements. The net

swap payments will fluctuate based on monthly changes in the receive rate. At December 31, 2017, the interest rate swaps had a net fair value of ($538.9) million.

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
	(dollars in thousands)				
Repurchase agreements	$77,211,230	$485,113	$—	$—	$77,696,343
Interest expense on repurchase agreements [(1)]	205,124	2,428	—	—	207,552
Other secured financing	3,657	1,449,081	2,384,790	—	3,837,528
Interest expense on other secured financing [(1)]	64,196	126,500	9,953	—	200,649
Securitized debt of consolidated VIEs (principal)	—	—	1,907,092	1,004,536	2,911,628
Interest expense on securitized debt of consolidated VIEs	63,399	126,798	125,673	183,570	499,440
Mortgages payable (principal)	—	23,375	—	289,125	312,500
Interest expense on mortgages payable	13,263	37,647	37,119	8,190	96,219
Long-term operating lease obligations	3,267	7,192	7,723	10,942	29,124
Total	$77,564,136	$2,258,134	$4,472,350	$1,496,363	$85,790,983

(1) Interest expense on repurchase agreements and other secured financing calculated based on rates at December 31, 2017.

In the coming periods, we expect to continue to finance our Residential Investment Securities in a manner that is largely consistent with our current operations via repurchase agreements. We may use FHLB Des Moines advances, securitization structures, mortgages payable or other term financing structures to finance certain of our assets. During the year ended December 31, 2017, we received $12.0 billion from principal repayments and $13.4 billion in cash from disposal of Residential Investment Securities. During the year ended December 31, 2016, we received $12.5 billion from principal repayments and $12.5 billion in cash from disposal of Residential Investment Securities.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships which would have been established for the sole purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

We have limited future funding commitments related to certain of our unconsolidated joint ventures. In addition, the Company has provided customary non-recourse carve-out and environmental guarantees (or underlying indemnities with respect thereto) with respect to mortgage loans held by subsidiaries of these unconsolidated joint ventures. We believe that the likelihood of making any payments under these guarantees is remote, and have not accrued a related liability at December 31, 2017.

Capital Management

Maintaining a strong balance sheet that can support the business even in times of economic stress and market

volatility is of critical importance to our business strategy. A strong and robust capital position is essential to executing our investment strategy. Our capital strategy is predicated on a strong capital position, which enables us to execute our investment strategy regardless of the market environment.

Our Internal Capital Adequacy Assessment Program (“ICAAP”) framework supports capital measurement, and is integrated within the overall risk governance framework. The ICAAP framework is designed to align capital measurement with our risk appetite.

Our capital policy defines the parameters and principles supporting a comprehensive capital management practice, including processes that effectively identify, measure and monitor risks impacting capital adequacy. Our capital assessment process considers the precision in risk measures as well as the volatility of exposures and the relative activities producing risk. Parameters used in modeling economic capital must align with our risk appetite.

The major risks impacting capital are liquidity, investment/market, credit, counterparty, operational and compliance, regulatory and legal risks. For further discussion of the risks we are subject to, please see Part I, Item 1A. “Risk Factors” of this annual report on Form 10-K.

Capital requirements are based on maintaining levels above approved limits, ensuring the quality of our capital appropriately reflects our asset mix, market and funding structure. As such we use a complement of capital metrics and related threshold levels to measure and analyze our capital from a magnitude and composition perspective. Our policy is to maintain an appropriate amount of available financial resources over the aggregate economic capital requirements.

Available Financial Resources is the actual capital held to protect against the unexpected losses measured in our capital management process and may include:

- Common and preferred equity
- Other forms of equity-like capital
- Surplus credit reserves over expected losses
- Other loss absorption instruments

In the event we fall short of our internal limits, we will consider appropriate actions which may include asset sales, changes in asset mix, reductions in asset purchases or originations, issuance of capital or other capital enhancing or risk reduction strategies.

Stockholders' Equity

The following table provides a summary of total stockholders' equity at December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
Stockholders' Equity:	(dollars in thousands)	
7.875% Series A Cumulative Redeemable Preferred Stock	$—	$177,088
7.625% Series C Cumulative Redeemable Preferred Stock	290,514	290,514
7.50% Series D Cumulative Redeemable Preferred Stock	445,457	445,457
7.625% Series E Cumulative Redeemable Preferred Stock	287,500	287,500
6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock	696,910	—
Common stock	11,596	10,189
Additional paid-in capital	17,221,265	15,579,342
Accumulated other comprehensive income (loss)	(1,126,020)	(1,085,893)
Accumulated deficit	(2,961,749)	(3,136,017)
Total stockholders' equity	$14,865,473	$12,568,180

Common and Preferred Stock

The following table provides a summary of options activity for the periods presented:

For the Years Ended:	Options Exercised	Aggregate Exercise Price	Shares Issued Through Direct Purchase	Amount Raised from Direct Purchase and Dividend Reinvestment Program
	(dollars in thousands, except per share data)			
December 31, 2017	—	$ —	219,000	$ 2,542
December 31, 2016	—	$ —	228,000	$ 2,362

December 31, 2015	—	$	—	221,000	$ 2,246

During the year ended December 31, 2017, we issued 140,450,700 shares of common stock for gross proceeds of approximately $1.7 billion before deducting offering expenses.

During the year ended December 31, 2017, we issued 28,800,000 shares of our 6.95% Series F Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock (the “Series F Preferred Stock”), liquidation preference of $25.00 per share, for gross proceeds of $720.0 million before deducting the underwriting discount and other offering expenses. The Series F Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at our option commencing from and including the original issue date to, but excluding September 30, 2022, at a fixed rate equal to 6.95% per annum of the $25.00 liquidation preference, and from and including September

30, 2022, at a floating rate equal to three-month LIBOR plus a spread of 4.993% per annum.

In August 2015, our Board authorized the repurchase of up to $1.0 billion of our outstanding common shares through December 31, 2016. During the year ended December 31, 2016, we repurchased 11,132,226 shares of our common stock under this repurchase program for an aggregate amount of $102.7 million. There were no common shares repurchased during the year ended December 31, 2017.

In March 2012, we entered into six separate Distribution Agency Agreements (“Distribution Agency Agreements”) with each of Merrill Lynch; Pierce, Fenner & Smith Incorporated; Credit Suisse Securities (USA) LLC; Goldman, Sachs & Co.; J.P. Morgan Securities LLC; Morgan Stanley & Co. LLC; and RCap Securities Inc. (“RCap”) (together, the "Agents"). Pursuant to the terms of the Distribution Agency Agreements, we may sell from time to time through the Agents, as our sales agents, up to 125,000,000 shares of our common stock. We did not make any sales under the Distribution Agency Agreements during the years ended December 31, 2017 or 2016.

Leverage and Capital

We believe that it is prudent to maintain conservative debt-to-equity and economic leverage ratios as there continues to be volatility in the mortgage and credit markets. Our capital policy governs our capital and leverage position including setting limits. Based on the guidelines, we generally expect to maintain an economic leverage ratio of less than 10:1. Our actual economic leverage ratio varies from time to time based upon various factors, including our Manager's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity, the availability of credit, over-collateralization levels required by lenders when we pledge assets to secure borrowings and our assessment of domestic and international market conditions.

Our debt-to-equity ratio at December 31, 2017 and December 31, 2016 was 5.7:1 and 5.8:1, respectively. Our economic leverage ratio, which is computed as the sum of Recourse Debt, TBA derivative notional outstanding and net forward purchases of investments divided by total equity, at December 31, 2017 and December 31, 2016 was 6.6:1 and 6.4:1, respectively. Our capital ratio, which represents our ratio of stockholders' equity to total assets (inclusive of total market value of TBA derivatives and exclusive of securitized debt of consolidated VIEs), was 12.9% and 13.1% at December 31, 2017 and December 31, 2016, respectively.

Risk Management

We are subject to a variety of risks in the ordinary conduct of our business. The effective management of these risks is of critical importance to the overall success of Annaly. The objective of our risk management framework is to identify, measure, monitor and manage these risks.

Our risk management framework is intended to facilitate a holistic, enterprise wide view of risk. We have built a strong and collaborative risk management culture throughout Annaly focused on awareness which ensures the key risks are understood and managed appropriately. Each employee of our Manager is accountable for monitoring and managing risk within their area of responsibility.

Risk Appetite

We maintain a firm-wide risk appetite statement which defines the types and levels of risk we are willing to take in

order to achieve our business objectives, and reflects our risk management philosophy. We only engage in risk activities based on our core expertise that aim to enhance value for our stockholders. Our activities focus on capital preservation and income generation through proactive portfolio management, supported by a conservative liquidity and leverage posture.

The risk appetite statement provides key parameters to guide our risk management activities. For a full discussion of our risk parameters, refer to the section titled "Business Overview" of Part I, Item 1. "Business."

Governance

Risk management begins with our Board, through the review and oversight of the risk management framework, and executive management, through the ongoing formulation of risk management practices and related execution in managing risk. The Board exercises its oversight of risk management primarily through the Board Risk Committee (“BRC”) and Board Audit Committee (“BAC”). The BRC is responsible for oversight of our risk governance structure, risk management and risk assessment guidelines and policies, our risk appetite and our capital, liquidity and funding practices. The BAC is responsible for oversight of the quality and integrity of our accounting, internal controls and financial reporting practices, including independent auditor selection, evaluation and review, and oversight of the internal audit function.

Risk assessment and risk management are the responsibility of our management. A series of management committees have oversight or decision-making responsibilities for risk management activities. Membership of these committees is reviewed regularly to ensure the appropriate personnel are engaged in the risk management process. Four primary management committees have been established to provide a comprehensive framework for risk management. The management committees responsible for our risk management include the Enterprise Risk Committee (“ERC”), Asset and Liability Committee (“ALCO”), Investment Committee and the Financial Reporting and Disclosure Committee (“FRDC”). Each of these committees reports to our management Operating Committee which is responsible for oversight and management of our operations including oversight and approval authority over all aspects of our enterprise risk management.

Audit Services is an independent function with reporting lines to the BAC. Audit Services is responsible for performing our internal audit activities, which includes independently assessing and validating key controls within the risk management framework.

Description of Risks

We are subject to a variety of risks due to the business we operate. Risk categories are an important component of a robust enterprise wide risk management framework. We have

identified the following primary categories that we utilize to identify, assess, measure and monitor risk.

Risk	Description
Liquidity Risk	Risk to earnings, capital or business arising from our inability to meet our obligations when they come due without incurring unacceptable losses because of inability to liquidate assets or obtain adequate funding.
Investment/Market Risk	Risk to earnings, capital or business resulting in the decline in value of our assets or an increase in the costs of financing caused by changes in market variables, such as interest rates, which affect the values of investment securities and other investment instruments.
Credit Risk	Risk to earnings, capital or business resulting from an obligor's failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in lending, and investing activities.
Counterparty Risk	Risk to earnings, capital or business resulting from a counterparty's failure to meet the terms of any contract or otherwise failure to perform as agreed. This risk is present in funding and hedging activities.
Operational Risk	Risk to earnings, capital, reputation or business arising from inadequate or failed internal processes or systems, human factors or external events. Model risk is included in operational risk.
Compliance, Regulatory and Legal Risk	Risk to earnings, capital, reputation or conduct of business arising from violations of, or nonconformance with internal and external applicable rules and regulations, losses resulting from lawsuits or adverse judgments, or from changes in the regulatory environment that may impact our business model.

Liquidity Risk Management

Our liquidity risk management strategy is designed to ensure the availability of sufficient resources to support our business

and meet our financial obligations under both normal and adverse market and business environments. Our liquidity risk management practices consist of the following primary elements:

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Element	Description
Funding	Availability of diverse and stable sources of funds.
Excess Liquidity	Excess liquidity primarily in the form of unencumbered assets.
Maturity Profile	Diversity and tenor of liabilities and modest use of leverage.
Stress Testing	Scenario modeling to measure the resiliency of our liquidity position.
Liquidity Management Policies	Comprehensive policies including monitoring, risk limits and an escalation protocol.

Funding

Our primary financing sources are repurchase agreements provided through counterparty arrangements and through RCap, other secured financing including funding from the Federal Home Loan Bank (“FHLB”), securitized debt, mortgages, credit facilities, note sales and various forms of equity. We maintain excess liquidity through liquid assets.

We conservatively manage our repurchase agreement funding position through a variety of methods including diversity, breadth and depth of counterparties and maintaining a staggered maturity profile.

Additionally, our wholly-owned subsidiary, RCap, provides direct access to third party funding as a FINRA member broker-dealer. RCap borrows funds through the General Collateral Finance Repo service offered by the Fixed Income Clearing Corporation (“FICC”), with FICC acting as the central counterparty. RCap may also borrow funds through other repurchase agreements.

To reduce our liquidity risk we maintain a laddered approach to our repurchase agreements. At December 31, 2017, the weighted average days to maturity was 58 days.

Our repurchase agreements generally provide that in the event of a margin call we must provide additional securities or cash on the same business day that a margin call is made.
Should prepayment speeds on the mortgages underlying our Agency and Residential mortgage-backed securities and/or market interest rates or other factors move suddenly and cause declines in the market value of assets posted as collateral, resulting margin calls may cause an adverse change in our liquidity position.

We maintain access to FHLB funding through our captive insurance subsidiary Truman. We finance eligible Agency,

residential credit and commercial investments through the FHLB. A rule from the Federal Housing Finance Agency (“FHFA”) requires captive insurance companies to terminate their FHLB membership, however, given the length of its membership, Truman has been granted a five year sunset provision whereby its membership will expire in February 2021. We believe our business objectives align well with the mission of the FHLB System. While there can be no assurances that such steps will be taken, we believe it would be appropriate for there to be legislative action to permit Truman and similar captive insurance subsidiaries to retain their membership status beyond the current sunset period.

We utilize diverse funding sources to finance our commercial investments. Aside from FHLB funding, we may utilize credit facilities, securitization funding and, in the case of investments in commercial real estate, mortgage financing and note sales.

At December 31, 2017, we had total financial instruments and cash pledged as collateral for secured financing arrangements and interest rate swaps of $87.4 billion. The weighted average haircut was approximately 4% on repurchase agreements. The quality and character of the Residential Investment Securities and commercial real estate investments that we pledge as collateral under the repurchase agreements and interest rate swaps did not materially change during the year ended December 31, 2017 compared to the same period in 2016, and our counterparties did not materially alter any requirements, including required haircuts, related to the collateral we pledge under repurchase agreements and interest rate swaps during the year ended December 31, 2017.

The following table presents our quarterly average and quarter-end repurchase agreement and reverse repurchase agreement balances outstanding for the periods presented:

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	Repurchase Agreements		Reverse Repurchase Agreements	
	Average Daily Amount Outstanding	Ending Amount Outstanding	Average Daily Amount Outstanding	Ending Amount Outstanding
Quarter Ended:	(dollars in thousands)			
December 31, 2017	$78,755,896	$77,696,343	$1,295,652	$ —
September 30, 2017	69,314,576	69,430,268	994,565	—
June 30, 2017	63,191,827	62,497,400	474,176	—
March 31, 2017	64,961,511	62,719,087	1,738,333	—
December 31, 2016	64,484,326	65,215,810	1,064,130	—
September 30, 2016	63,231,246	61,784,121	1,494,022	—
June 30, 2016	54,647,175	53,868,385	1,159,341	—
March 31, 2016	55,753,041	54,448,141	1,294,505	—
December 31, 2015	57,483,870	56,230,860	214,674	—

The following table provides information on our repurchase agreements and other secured financing by maturity date at December 31, 2017. The weighted average remaining maturity on our repurchase agreements and other secured financing was 107 days at December 31, 2017:

	December 31, 2017		
	Principal Balance	Weighted Average Rate	% of Total
	(dollars in thousands)		
1 day	$—	— %	— %
2 to 29 days	33,956,552	1.69 %	41.6 %
30 to 59 days	10,828,777	1.44 %	13.3 %
60 to 89 days	13,855,787	1.59 %	17.0 %
90 to 119 days	10,128,006	1.39 %	12.4 %
Over 120 days [(1)]	12,764,749	1.73 %	15.7 %
Total	$81,533,871	1.61 %	100.0%

(1) Approximately 5% of the total repurchase agreements and other secured financing had a remaining maturity over 1 year.

The table below presents our outstanding debt balances and associated weighted average rates and days to maturity at December 31, 2017:

	Principal Balance	Weighted Average Rate As of Period End	For the Quarter	Weighted Average Days to Maturity [(1)]
	(dollars in thousands)			

Repurchase agreements	$77,696,343	1.61%	1.41 %	58
Other secured financing [(2)]	3,837,528	1.66%	1.78 %	1,114
Securitized debt of consolidated VIEs [(3)]	2,911,628	2.18%	2.10 %	2,574
Mortgages payable [(3)]	312,500	4.24%	4.34 %	2,588
Total indebtedness	$84,757,999			

(1) Determined based on estimated weighted-average lives of the underlying debt instruments.
(2) Includes advances from the Federal Home Loan Bank of Des Moines of $3.6 billion and financing under credit facilities.
(3) Non-recourse to Annaly.

Excess Liquidity

Our primary source of liquidity is the availability of unencumbered assets which may be provided as collateral to support additional funding needs. We target minimum

thresholds of available, unencumbered assets to maintain excess liquidity. The following table illustrates our asset portfolio available to support potential collateral obligations and funding needs. Assets are considered encumbered if pledged as collateral against an existing liability, and therefore no longer available to support additional funding. An asset is considered unencumbered if it has not been pledged or securitized. The following table also provides the

carrying amount of our encumbered and unencumbered financial assets at December 31, 2017:

	Encumbered Assets	Unencumbered Assets	Total
	(dollars in thousands)		
Financial Assets:			
Cash and cash equivalents	$579,213	$ 127,376	$706,589
Investments, at carrying value: (1)			
Agency mortgage-backed securities	83,628,132	6,275,008	89,903,140
Credit risk transfer securities	363,944	287,820	651,764
Non-Agency mortgage-backed securities	516,078	581,216	1,097,294
Residential mortgage loans	1,169,496	268,826	1,438,322
MSRs	5,224	575,636	580,860
Commercial real estate debt investments	3,070,993	18,115	3,089,108
Commercial real estate debt and preferred equity, held for investment	520,329	508,998	1,029,327
Corporate debt	600,049	411,226	1,011,275
Total financial assets	$90,453,458	$ 9,054,221	$99,507,679

(1) The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

We maintain liquid assets in order to satisfy our current and future obligations in normal and stressed operating environments. These are held as the primary means of liquidity risk mitigation. The composition of our liquid assets is also considered and is subject to certain parameters. The composition is monitored for concentration risk and asset type. We believe the assets we consider liquid can be readily converted into cash, through liquidation or by being used as

collateral in financing arrangements (including as additional collateral to support existing financial arrangements). Our balance sheet also generates liquidity on an on-going basis through mortgage principal and interest repayments and net earnings held prior to payment of dividends. The following table presents our liquid assets as a percentage of total assets at December 31, 2017:

Liquid Assets	Carrying Value (1)	
	(dollars in thousands)	
Cash and cash equivalents	$706,589	
Residential Investment Securities (2)	91,652,198	
Residential mortgage loans	1,438,322	
Commercial real estate debt investments (3)	262,751	
Commercial real estate debt and preferred equity, held for investment	667,413	
Corporate debt	661,940	
Total liquid assets	$95,389,213	
Percentage of liquid assets to carrying amount of encumbered and unencumbered financial assets (3)	98.66	%

(1) Carrying value approximates the market value of assets. The assets listed in this table include $87.6 billion of assets that have been pledged as collateral against existing liabilities at December 31, 2017. Please refer to the

Encumbered and Unencumbered Assets table for related information.

(2) The amounts reflected in the table above are on a settlement date basis and may differ from the total positions reported on the Consolidated Statements of Financial Condition.

(3) Excludes senior securitized commercial mortgage loans of consolidated VIEs carried at fair value of $2.8 billion.

Maturity Profile

We consider the profile of our assets, liabilities and derivatives when managing both liquidity risk as well as investment/market risk employing a measurement of both the maturity gap and interest rate gap.

We determine the amount of liquid assets that are required to be held by monitoring several liquidity metrics. We utilize several modeling techniques to analyze our current and potential obligations including the expected cash flows from our assets, liabilities and derivatives. The following table

illustrates the expected final maturities and cash flows of our assets, liabilities and derivatives. The table is based on a static portfolio and assumes no reinvestment of asset cash flows and no future liabilities are entered into. In assessing the maturity of our assets, liabilities and off balance sheet obligations, we use the stated maturities, or our prepayment expectations for assets and liabilities that exhibit prepayment characteristics. Cash and cash equivalents are included in the ‘Less than 3 Months’ maturity bucket, as they are typically held for a short period of time.

With respect to each maturity bucket, our maturity gap is considered negative when the amount of maturing liabilities exceeds the amount of maturing assets. A negative gap increases our liquidity risk as we must enter into future liabilities.

Our interest rate sensitivity gap is the difference between Interest Earning Assets and Interest Bearing Liabilities maturing or re-pricing within a given time period. Unlike the calculation of maturity gap, interest rate sensitivity gap includes the effect of our interest rate swaps. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling

interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if assets and liabilities were perfectly matched in each maturity category. The amount of assets and liabilities utilized to compute our interest rate sensitivity gap was determined in accordance with the contractual terms of the assets and liabilities, except that adjustable-rate loans and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature. The effects of interest rate swaps, which effectively lock in our financing costs for a longer term, are also reflected in our interest rate sensitivity gap. The interest rate sensitivity of our assets and liabilities in the table below at December 31, 2017 could vary substantially based on actual prepayment experience.

	Less than 3 Months	3-12 Months	More than 1 Year to 3 Years	3 Years and Over	Total
Financial Assets:	(dollars in thousands)				
Cash and cash equivalents	$706,589	$ —	$ —	$ —	$ 706,589
Agency mortgage-backed securities (principal)	410,000	—	2,627,679	82,758,400	85,796,079
Credit risk transfer securities (principal)	—	—	—	593,027	593,027
Non-Agency mortgage-backed securities (principal)	—	42,692			